In the

Supreme Court of the United States

October Term, 1942.

No. 319.

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY,

Petitioners.

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.

Respondents.

REPLY BRIEF ON BEHALF OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER FOR FIDELITY ASSURANCE ASSOCIATION, IN THE STATE OF MISSOURI.

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BAIRD-WARD—NASHVILLE

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FOREWORD.

"We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of the reorganization of the business as a going concern, but only the *immediate** need of a liquidation of the company's assets for the benefit of the contract holders."

Opinion of Court of Appeals, Tr., p. 259

"It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face-amount certificate company."

Opinion of District Judge, Tr., pp. 194-195.

*All italics herein are ours unless otherwise noted.

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STATEMENT AS TO THE ISSUES—GOOD FAITH.

Other respondents will discuss the question of whether or not Fidelity Assurance Association was such a corporation as could file a petition in bankruptcy. This brief will be confined to the question of good faith, and chiefly to that

phase pertaining to whether or not there is a reasonable likelihood of a plan of reorganization being effected.

The issues as regards this aspect of the case, no longer admit of any canon. They have gone on a rampage and are like the surging floodwaters that have broken out of the banks of the river channel. They are like Mistress Quickly of whom Falstaff said "A man knows not where to have her."

The Debtor's petition filed June 6, 1941, (Tr., p. 4) indicated a purpose of effecting reorganization through a modification of the rights of all contract holders in the security of the deposits with the Treasurer of the State of West Virginia and the officials and departments of other States, "so that the earnings received on securities and assets owned by Debtor will be sufficient in amount to meet the requirements under its outstanding contracts." (Tr., p. 7-8)

Debtor's pleading pitches its case for reorganization on this single issue.

This issue has either been overlooked or forgotten by counsel presently in the case. The case in this Court is made to rest upon the possibilities of *liquidation*. If the pleadings in the Chapter X proceedings on the issue of good faith serve the same purpose of pleadings in the ordinary equity case, in the case at bar there is ample cause to question whether the case put forward in the adversary briefs is not subject to the usual rules as to variance.

We regard the findings of the Circuit Court of Appeals and the District Court as being concurrent on the point of whether or not the Company can be reorganized to carry on

business. The brief of Securities & Exchange Commission indicates that it has the same view.

Petitioners and Securities & Exchange Commission know that the crucial question in this lawsuit is whether or not there is a reasonable likelihood of effecting a reorganization of Fidelity that will be *fair, equitable* and *feasible*. If they thought that Fidelity could be reorganized, they ought to have been able to say so in plain and direct language.

Nevertheless, we search their brief in vain for a single clear statement that *they* envisage the kind of reorganization which men ordinarily think of when they speak of reorganizing a corporation. When they come to this point, they skip over it with the agility of an expert skater jumping over a row of barrels and instantaneously commence talking about "other methods of disposition of the assets which will satisfy the requirements of Section 146 (3), such as "the creation of a new corporation or other *device to liquidate assets*." (Brief of Securities & Exchange Commission, p. 19)

It is true that the debtor and its Trustee in their brief refer to the opinion of several of the witnesses that Fidelity could be reorganized and add that there was much atmosphere or "color" about this proceeding substantiating these opinions. We submit that their opinions are entitled to be given very little weight. None of them are supported by any basis of fact from which such conclusion might legitimately be drawn. All of them had had some connection with the Company before the filing of the petition for reorganization, which made them interested (though not in each case pecuniarily) in saving Fidelity from dissolution.

It is a human disposition to postpone the admission of the inevitableness of failure and defeat as long as possible. A case in point is the profession of the leaders of France of a belief that some miracle would save her in the Spring of 1940, when the outside world knew that she was doomed.

The opinions of these witnesses that Fidelity could be reorganized were little more than the expression of hopes born of despair. The letter of John Marshall, dated June 17, 1941, to the publisher of the Wheeling *Intelligencer* (Original Tr. pp. 163-169) attests this fact. This is why the Court of Appeals said that the situation must be viewed realistically.

The Debtor and the Trustee make numerous suggestions —none of which they are ready to pin their faith on—and claim that they are "something" more than "remote possibilities." (Petitioner's Brief, p. 48) They completely fail, however, to conform any of these "suggestions" to the realities with which they must deal.

THE STATE DEPOSITS—THE CRUX OF THE LAWSUIT.

The confusion that is so manifest in the thinking of petitioners and Securities & Exchange Commission is attributable to one thing—their refusal to reorganize the fixed and vested rights of contract holders in the deposits in West Virginia and the fourteen other states. Perhaps we should say that they refuse to *admit* that these fixed and vested rights exist. We are bound to credit them with *perceiving* these rights.

True it is, that insolvency alone will not bar reorganization. But insolvency coupled with the utter absence of any

likelihood of achieving solvency does bar reorganization. That is the case here.

The Circuit Court of Appeals summarized the situation by setting out in its opinion the following table and stating:

"State	Deposit by States as of June 6, 1941 Market Value	Liability by States as of April 10, 1941 Net Cash
Alabama	$ 32,555.16	$ 31,346.71
Delaware	293,790.63	290,175.36
Illinois	3,759,894.00	4,225,790.75
Indiana	162,863.44	386,173.45
Iowa	45,082.50	34,478.27
Kansas	83,337.50	108,784.89
Kentucky	86,712.50	92,690.42
Maryland	470,806.25	492,552.24
Missouri	861,100.62	786,988.86
Ohio	509,573.44	2,360,418.70
Pennsylvania	232,591.57	4,668,582.25
Tennessee	196,574.38	200,504.97
Virginia	27,703.13	557,809.19
West Virginia*	10,674,696.08	6,896,393.88*
Wisconsin	2,619,399.07	2,342,978.73
	$20,056,680.27	$23,475,668.67

In addition, the Fidelity had undeposited securities of the market value of $556,467.51 on June 6, 1941, and approximately $500,000 in cash."

(Tr., p. 242)

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*Of the liabilities shown opposite West Virginia $2,181,681.75 represent claims of West Virginia contract holders, and the balance of $4,714,712.13 the claims of contract holders in the States having no deposits.

The Federal Government has filed a preferred claim for income and excess profit taxes for the taxable years 1935, 1936, 1937, 1938 and ten months of 1939, amounting to nearly $300,000.00. (Tr., pp. 1220-1223) It is plainly to be seen that the nondeposited securities and assets would be practically consumed in paying taxes, expenses of administration, fees, etc.

Manifestly, no sort of a plan of reorganization could be effected which does not deal with the deposited securities. Debtor's petition presupposes some kind of omnipotence in the Federal Court capable of effecting a recapture of these deposits for use in supplying the deficiency of more than two and a half million dollars between the assets and liabilities of the company so that it can continue in business. In other words, it necessarily contemplates the carving of working capital out of the assets held in trust for contract holders.

There could be no sort of reorganization that does not eliminate the deficiency between assets and liabilities. If the company is to continue in business as a face-amount certificate company, as an insurance company, or as any other kind of company, it would have to be launched in a condition of solvency. The only other alternative, it occurs to us, would be the sale or transfer of a part of the Debtor's business to some other company that is already functioning; and again insolvency is a barrier to such a plan. No business man would take over assets with liabilities in excess of what he is getting.

Now when a business is insolvent—that is, when its liabilities are in excess of its asset—solvency can be attained in one of two ways only. Either the assets must be increased or the liabilities must be decreased. The assets of this com-

pany can be brought up to equal its liabilities only by new money being put in from the outside. All will agree that this is out of the question. The efforts of the company's directors and officers extending over a period of several years prior to the filing of the petition to bring in new capital demonstrate that this possibility has already been exhausted.

This leaves the possibility of scaling down the liabilities. It would not be enough to make them merely equal the assets. The liabilities would have to be brought way below the assets so as to free money from the trusts in which the securities are held to make capital and for use in paying operating expenses.

It is our belief that nothing like this has ever been attempted in the annals of corporate reorganizations. The crucial question in the case, therefore, is: How can the Bankruptcy Court use the State deposits as a basis for reorganization?

At the commencement of this proceeding it was reorganization through *modification* of the contract holders rights in the State deposits which was sought. Now, petitioners and Securities & Exchange Commission's plea is for reorganization through *exploration*, as to these contract holders rights. It has simmered down to this! *Does the good faith requirement of Chapter X mean nothing more than that a Bankruptcy Court will have jurisdiction of a reorganization petition to enable Securities & Exchange Commission to investigate and explore in order to see if it cannot devise some method of disposition of the bankrupt's assets "as slowly as necessary and as expeditiously as possible under the circumstances?"*

But whether the proponents of reorganization are thinking of reorganization in the usual sense or an exploration with a view to the creation of a new corporation or some other device for liquidation, they must face—as so far they will not—the dominant fact in this lawsuit: That there is nothing to work with except the $10,000,000 of securities held in the West Virginia deposit and a like amount held in the deposits in the fourteen other States and *that these deposits they cannot touch.* Another proposition is equally true: That they cannot torture Chapter X of the Bankruptcy Act so as to make it serve this end.

THERE ARE NO PROBLEMS OF "MARSHALING" ASSETS.

There need not be, in the case of Fidelity, any complex and difficult problems of creditors' rights involving the marshalling of assets. The distribution of Fidelity's deposits can be simple and easy. When the case is seen in it true light, there are no perplexing legal problems.

In the first place there is no conflict between contract holders in the States which have deposits and contract holders in the States which do not have their own deposits. The simple fact is that fourteen States outside of West Virginia required Fidelity to make deposits of assets to secure liabilities in those States. About the same number of other States did not have such requirements in their laws. They were content to rely upon the protection afforded by the laws of the State of West Virginia which required a deposit in that State to cover all outstanding liabilities that were not elsewhere secured.

Securities & Exchange Commission, instead of speaking of "unsolved" problems of "interfund accountings and marshalling of assets by series" which does create confusion, should have stated its proposition in plainer terms. "Marshalling" in the sense in which they have employed it means nothing more nor less than the annihilation of the State deposits. It is but a recurrent phase of the old attempt to lay hold upon the State deposits. Instead of *modifying* the contract holders rights in the State deposit, they are now talking about *marshalling* the assets.

That Fidelity sold more than one series of contracts, that it failed to segregate the moneys which it received according to the contract series, and that its books show some interfund "loans" or other transfers, do not alter the fact that contract holders have vested rights in the securities deposited in the several State deposits at the time of the filing of the petition. These rights cannot be modified against the contract holders' consent. They cannot be abrogated indirectly by some kind of "marshalling" of the securities as between the several deposits.

It will clarify the confusion—arising not so much from the actual situation as from the way it has been presented in the adversary briefs—for us to look to the condition under which the State deposits were created. The difficulties which obsess Securities & Exchange Commission vanish as soon as we stop pondering "the complex task of disentangling the assets" and examine the facts.

STATE DEPOSITS CONSTITUTE TRUST FUNDS FOR CONTRACT HOLDERS.

The statutes of the State of Tennessee require investment companies, such as the Debtor, as a condition to the right to engage in business in that State, to deposit and maintain securities at no time less than 100 per cent of the issuing company's cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. By Chapter 209 of the Public Acts of 1939, it was provided that the Commissioner of Insurance and Banking of the State of Tennessee should hold as Custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of said Act. By Chapter No. 157 of the Public Acts of 1941, the State Treasurer of Tennessee was made the Custodian of all securities deposited with the State or any Department thereof. The laws of Tennessee further provide that only upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee, and for which trust deposit is maintained, shall the issuing company be entitled to a release and return of the securities so deposited.

In compliance with the laws of the State of Tennessee, and in order to obtain a permit to do business and issue its investment contracts in the State of Tennessee, the Debtor company made a deposit of securities with the Commissioner of Insurance and Banking of the State of Tennessee. Citizens of the State of Tennessee, in reliance upon the protection afforded by the laws of that State, purchased the investment contracts issued by Debtor.

The evidence adduced on the hearing discloses that the company, in the latter years of its existence, was able to

keep its head above water by issuing certificates with some variation in name and terms or features.* The implications in the brief of Securities & Exchange Commission that it was only in the later series of contracts that Fidelity agreed to segregate reserve funds are not correct.

The different contracts themselves when analyzed furnish conclusive evidence that no trust could come into existence until securities were deposited with State officials. In the first place, the contract holder was to make his payments *to the Company.* Undoubtedly when these payments were received by the Company a *debtor-creditor* relationship and not a *trust* arose. The Company agreed unconditionally (so far as reserve funds were concerned) to make the payments to the contract holder when due according to the terms of the contract. The point is that the Company did not agree to pay merely *out* of the separate reserve fund. The contract holder's right to receive the payments from the Company was not limited to any special or segregated fund.

In the Series B contract which was issued from 1934 on, the heading read:

"PROVISIONS.

This contract is issued upon the agreement of the association to maintain the required reserve fund, to distribute the apportioned surplus thereof to registered holders of matured income reserve contracts series B, *to deposit approved securities in trust as required by the laws of the State of West Virginia* and to pay and retire contracts in accordance with their provisions."

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*For the different types of contracts or certificates and the varying terms and provisions thereof, see pages 79-80 and 164 of the Report of the Securities & Exchange Commission on *Companies Issuing Face-Amount Installment Certificates.*

While there is some slight difference between the wording of the section relating to the reserve fund contained in the different contracts, in substance the provision is the same. By this section (Section 1, Reserve Fund), the Company agreed to *create* and maintain a reserve fund. It was to be a special fund for the discharge of its liability under the different Series contracts. The reserve fund was to be set aside from payments received under the different Series contracts. This reserve fund was to be invested in approved securities *and deposited in trust, as required by the laws of the State of West Virginia.*

It is of special significance that the amount set aside for the reserve fund was to be the *total* amount of all payments, less administrative and agency charges, withdrawals and taxes. This, we believe, is a fair statement of the provisions of the Series B contracts. For the Special Annuity contracts, the amount set aside was to be the amount of all payments, less fixed administrative charges and necessary agency expenses. The Special Annuity contracts did not provide for the deduction of withdrawals and taxes.

Therefore, the entire amount paid in, less running expenses, was to constitute the reserve fund. This fund was to be created when it was invested in approved securities. So long as they were held by the Company, they were still general or unpledged assets. Only when the securities were *deposited in trust*, as required by the laws of the State of West Virginia, did a trust come into existence.

The laws of the State of West Virginia required a deposit *in trust* of bonds and securities approved by the Insurance Commissioner "to an amount equal to the total amount which such person, association or corporation may be liable

to pay in cash to the holders of contracts under the terms thereof at the time of the deposit." As stated by the Court of Appeals in its opinion, it was further provided by the West Virginia laws that wherever other States required the corporation to make deposits to secure contract holders, the amount of the deposits in such other States might be deducted from the total amount required to be deposited with the Treasurer of the State of West Virginia.

These provisions, which were a part of the West Virginia laws, were, of course, by the provisions of the contract incorporated as a part of the contractual obligations of the Investment Company. Thus, when the Company deposited securities in Tennessee in accordance with the laws of the State of West Virginia, credit therefor was given against the West Virginia deposit. This was in compliance with the provisions of the contract that a reserve fund would be invested in approved securities and *deposited in trust*. The Tennessee statutes in this regard are unambiguous. The amount of the deposit was to be not less than one hundred per cent of the cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee.

Clearly no valid trust came into existence at any time until the securities were deposited by the company with the State depositaries. This means, of course, change of possession, actual or constructive. Such book entries as the Company made for the purpose of segregating reserve funds by series contracts plainly did not amount to the creation of a separate trust for the contract holders of the different series. In the first place, there was no agreement that the Company itself would be a trustee. The contract did not contemplate

that there would be a trust fund or *res* until the reserve fund was deposited *in trust* as required by the States laws.*

The applicability of a principle which makes a trust *res* necessary for the creation of a trust is emphasized by the facts, so well illustrated in this record that, until the Company transferred securities to the State depositaries, they were still (notwithstanding bookkeeping entries) under the unrestricted dominion and control of the Company. They should be "switched" about from one ledger account to another. They could be "loaned," or "advanced." The record shows many such transactions in very large sums. There was no attempt even to make separate bookkeeping entries until the latter years of the Company's existence. (See complaint filed by S. E. C. and supporting affidavits in Report on Companies Issuing Face-Amount Installment Certificates, pp. 196, *et seq.*)

The evidence shows that with comparatively few exceptions (which are trivial and must be disregarded in the approach to the primary and basic question of the rights of contract holders in the State deposits generally) the Company in sending deposits to the State depositaries, did not specify the particular series fund from which the securities came. (Tr., pp. 754-756, 768, 769) The types of reports which were sent out are shown by Exhibits 72, 73, 74, 75, 76, 77 and 78.

***McKey v. Paradise*, 299 U. S., 119, 57 S. Ct., 124 81 L. Ed., 75; *Blakey v. Brinson*, 286 U. S., 254, 52 S. Ct., 516; 76 L. Ed., 1089; *National City Bank v. Hotchkiss*, 231 U. S., 50, 34 S Ct., Rep., 20, 58 L. Ed., 115;

Restatement Law of Trusts, Sec. 87.

The law in West Virginia was settled by its Supreme Court of Appeals in the recent case of *Inter-Ocean Casualty Company v. Leccony Smokeless Fuel Company, et al*—W. Va.—17 S.E. (2d) 51, 137 A.L.R., 488, in accordance with the rule of *McKey v. Paradise*, 299 U. S., 119, 57 S. Ct., 124, 81 L. Ed., 75.

The Securities & Exchange Commission fails to cite the record in support of its statement that the States accepted securities in disregard of knowledge or notice that the assets deposited belonged to particular series funds and were deposited to secure liabilities of other series. (Brief, pp. 36-37) There is no evidence that this happened. To make it perfectly clear, we are printing in the Appendix to our brief copies of the reports sent to Tennessee which were filed as Exhibit 77. (Tr., p. 756)

It has not been suggested that the rights of contract holders in the State deposits may be so far ignored as to bring all the deposited securities into one general pot with the general assets of Debtor so as to make all contract holders mere general creditors. All that is proposed is some "disentangling" of the assets by series funds. It would seem that nothing short of some superior rights of contract holder springing from a trust relationship by series funds would warrant such an invasion of the State deposits.

It will tend to clarify all the other points in the case, if we consider two fundamental legal propositions as established:

(a) No trust relationship between Fidelity and any series of contract holders ever arose or now exists or may hereafter be created by reason of the agreement of Fidelity expressed in the contracts to create and maintain separate reserve funds for each series contract; and

(b) Valid trusts or pledges of collateral security creating vested rights in favor of the contract holders entitled to benefit therefrom did come into existence when securities were deposited by the Company with State depositaries.

The relationship between Fidelity and the contract holders is that of debtor and creditor, pure and simple. The State deposit laws, and not the contracts, give rise to the trust relationship. By virtue of the statutes requiring the deposits, the contract holders entitled to the benefits therefrom as a matter of State policy acquired protective lien or trust rights in the deposited securities superior to those of the company or its other creditors in such assets. *American United Life Insurance Company* v. *Fischer* (C.C.A. 8th) 130 F. (2d) 643, 646.

When the brief of Securities & Exchange Commission is carefully read, it will be seen that the Commission avoids expressing any view of its own contrary to these propositions. To our minds, it is clear that the Commission does not have the conviction that an attempt by contract holders to set up trust funds according to the several series of contracts in derogation of State deposit laws will be successful. Disappointed contract holders may have claims against the company for breach of the agreement to create and maintain separate reserve funds by each series contract, but the attempt to enforce such claims will avail them nothing, because they can point to no trust *res* which they are entitled to trace. Those contract holders who are entitled to the benefit of the State deposits stand as *bona fide* purchasers having vested lien or trust rights in the disputed securities. *American United Life Insurance Company* v. *Fischer*, *Supra*.

This view is confirmed by the statement on Page 1 of the Report of Securities & Exchange Commission on Companies Issuing Face-Amount Installment Certificates that, irrespective of their designation, **these face-amount installment** certificates are in essence simply unsecured obligations of

the companies which issue them to pay a specified sum to the holder at a specified future date. The footnote mentions the trusts by reason of the State deposit laws.

The authors of the brief on behalf of Debtor and the Trustee are almost as circumspect as the Commission. Although they say it is a "real question" whether any or all of the several series of contracts have resulted in the creation of trusts in particular assets for the benefit of creditors (p. 57), they are extremely careful to avoid vouching such a theory. Not one of our adversaries has the rashness to assert that any of the several series of contracts resulted in the creation of trusts in particular assets, except insofar as trusts came into being by reason of the State laws.

From whence then arise any rights or equities in favor of any contract holders which are superior to the vested rights of contract holders in the States having the deposits? *Securities & Exchange Commission ought to be willing to answer this question or cease all talk about marshalling the several State deposits.*

All contract holders in this case are secured creditors, for all are entitled to the benefit of the security of the West Virginia deposit. But contract holders claiming their security, not by virtue of any State deposit, and instead claiming securities held in State deposits on the theory of a trust relatonship resulting from a contractual obligation of Fidelity, will find themselves in the position of common or unsecured creditors. At least they will be insofar as they may seek to recover securities from the States having the deposits. The mere equities which they assert will be subordinate to the substantive rights in the deposited securities which had previously vested under the State laws and which by virtue of the insolvency and receivership proceedings

had acquired an exclusively local situs. *American United Life Insurance Company* v. *Fischer, Supra.*

Any plan which compels secured creditors to surrender without adequate consideration to the benefit of other creditors, whether secured or unsecured, the superior rights which they have acquired is inequitable and unfair. *Consolidated Rock Products Company* v. *Du Bois*, 312 U. S., 510, 61 S. Ct., 675, 85 L. Ed., 982.

Surely there can be no gainsaying the following statement by the Court of Appeals:

> "... *certainly the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. No proposal for the investment of new capital has been forthcoming.* The facts underlying the whole situation are so clear that even the parties in this case who insist upon reorganization under the Bankruptcy Act hold out little hope of a resumption of the business as a going concern, and content themselves for the most part with the argument that reorganization in the statutory sense includes 'a slow and orderly liquidation.'" (Tr., p. 260)

A Bankruptcy Court is a Court of equity, but it cannot disregard or impair liens created by State laws. This is prohibited by Section 67 (b) of the Bankruptcy Act, which, by virtue of Section 102, is applicable to proceedings under Chapter X. If the Bankruptcy Court has no power to destroy, abridge or adjust a State deposit, may it hold that the petition to reorganize is filed in good faith merely in order to afford opportunity to the Trustee to try to discover ways of doing that?

CONGRESS HAS CONFERRED NO POWER IN BANKRUPTCY COURT OVER FIDELITY'S DEPOSITS.

Fidelity never came under any Federal regulation. During its entire existence it was regulated by the State authorities. All of the deposits which were made were in pursuance to State laws. No reason whatsoever is shown why the Federal Court should have any jurisdiction to nullify the rights which have been thus created.

The Securities & Exchange Commission had been studying investment trusts and investment companies for four years before the Investment Company Act undertaking to regulate face-amount certificate companies was recommended to Congress for enactment. The study was commenced in pursuance to the mandate contained in Section 30 of the Public Utility Holding Company Act of 1935.

The Investment Company Act of 1940 (Title 15 U.S.C.A., Sec. 80a) expressly recites that it was upon the basis of facts disclosed by the record and reports of Securities & Exchange Commission and facts otherwise disclosed and ascertained, that it was found that investment companies were affected with a national public interest. The special report on *Companies Issuing Face-amount Installment Certificates* was a part of its over-all report on its study of investment trusts and investment companies. Chapter V of this Special Report deals with the subject of Governmental Regulation of face-amount certificate companies.* These deposits with State officials of cash and securities are referred

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*It is significant that it was reported that these companies "are essentially moneyed corporations, the regulation of which would seem to present problems in many respects comparable to the regulation of other types of moneyed corporations *such as insurance companies and banks.*" (p. 125)

to as "collateral security for the performance of the Company's obligations." (Page 128) On the same page is set out a summary of the deposit requirements of the various State statutes. Table 34 on Page 130 sets out the amount of deposits and cash surrender liability of certificates outstanding of Fidelity Investment Association by States as of December 31, 1937.

In 1938, the Securities & Exchange Commission had obtained an injunction in the United States District Court for the Eastern District of Michigan against Fidelity Investment Association, enjoining it, among other things, from: "A. 1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements." (Special Report, p. 257).

The variation in State deposit laws was made the subject of a special study by the Senate and House Committees, to which the Investment Company Act was referred. Commissioner Healy was the first to point it out. (See hearings before Sub-Committee of the Committee on Interstate and Foreign Commerce on H.R. 10065, Page 62.)

Mr. Schenker, counsel for the Securities & Exchange Commission made the following statement:

"... this bill in no way, Senator Herring, touches deposits that have been made to secure certificates issued up to the time of the passage of this bill." (Original printed transcript, p. 234)

The report of Senator Wagner, Chairman of the Committee on Banking and Currency, accompanying the bill, states:

"*The bill preserves the rights of residents in those States which require specific deposits with their State officials but makes provision for equalization of treatment of all certificate holders,* by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits before the latter can share in the general assets of the bankrupt company. (Sec. 29.)" (Italics ours)

We ask the Court to give special attention to the memorandum as to the hearings preceding the enactment of the Bill set out in the original printed transcript at pages 226 to 237.

It is highly significant that the Securities & Exchange Commission in its report to Congress stated that neither of the two major companies (Fidelity Investment Association and Investors Syndicate) had registered their certificates under the Securities Act of 1933 "presumably by reason of the exemption in Section 3 (a) (8) of that Act." The footnote to said sentence points out that:

"Sec. 3 (a) (8) of the Securities Act of 1933 includes among the securities exempted from the registration and prospectus requirement of the Act, 'any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.'"

Part Two. Statistical Survey of Investment Trusts and Investment Companies, p. 228;

See also p. 132, Report on *Companies Issuing Face-Amount Installment Certificates.*

Commissioner Healy, in his statement before the Sub-Committee of the Committee on Banking and Currency of the United States Senate, preceding the passage of the bill, compared these companies to savings banks (Part One hearings on S. 3580, pp. 33, 38).

Thus, until the enactment of the Investment Company Act of 1940, the Securities & Exchange Commission evidently held the view that investment companies selling face-amount certificates were exempted from the registration of their certificates under the Securities Act of 1933.*

It is as plain as the noon-day that so far as Fidelity is concerned no greater power over State deposits exists in the Bankruptcy Court since the enactment of the Investment Company Act, than there was before. We have seen that it was not the intention of Congress to disturb the State deposits as they existed on the effective date of the Act, which was January 1st, 1941. As Mr. Schenker stated to the Senate Sub-Committee on Banking and Currency, "meticulous care" was taken to see that those States wich had de-

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*By the same token, it would seem that a face-amount certificate company would not be the type of corporation that could file a petition in bankruptcy, because it possessed the essential characteristics of an insurance or banking corporation. (Sec. 4 (b) of the Bankruptcy Act.)

**It is worthy of note that neither prior to the enactment of the Investment Company Act nor as a result of the amendment to that Act was any *special* provision made for the *reorganization* of face-amount certificate companies. Whereas, the Bankruptcy Act contained separate chapters with carefully framed provisions concerning Agricultural Compositions and Extensions, Railroad Reorgnizations, Debt Readjustments by Municipalities and Taxing Districts, Corporate Reorganizations, Arrangements, Real Property Arrangements and Wage Earners Plan, this simple amendment designed to facilitate the *liquidation* of face-amount certificate companies and the distribution of the deposits made after January 1, 1941 was added by the Investment Company Act as an amendment to Section 67 of the Chapter relating to ordinary bankruptcy. It is in such striking contrast to the carefully detailed methods set up with respect to other types of corporations as to make it exceedingly doubtful whether in any event there would be jurisdiction in the Bankruptcy Court, to attempt to *rehabilitate* a face-amount certificate company as a going concern. But this is not a determinative question.

posits could hold on to them. (Original printed Transcript, p. 229)

The Investment Company Act embodied a separate section headed "Bankruptcy of Face-Amount Certificate Companies." This Section 29 undertakes to amend Section 67 of the Bankruptcy Act so as to give the Bankruptcy Court summary jurisdiction over State deposits in proceedings for the *liquidation* of face-amount certificates companies.**

Section 29 expressly provides that it applies only to the deposit of securities made by a face-amount certificate company on or after January 1, 1941. Deposits made prior to that time may not be avoided by the Trustee, and the Bankruptcy Court is given no summary jurisdiction of any proceedings to hear and determine the rights of any parties with respect to such deposits. It is to be borne in mind that all of the deposits of Fidelity were made prior to January 1, 1941.

The Act contained an express reservation of the jurisdiction of State authorities. Section 50 provides as follows:

> ". . . nor shall anything in this title effect the jurisdiction of any other commission, board, agency, or officer of the United States or of any State or political subdivision of any State, over any person, *security*, or transaction, insofar as such jurisdiction does not conflict with any provision of this title or of any rule, regulation, or order hereunder."

The proof is irrefragable that Congress thoroughly considered the question of the application of the bankruptcy power to the then existing deposits and deliberately decided

to confer *no power* upon the Bankruptcy Court over deposits as they existed when the Act took effect.

Fidelity's deposits before the Investment Company Act was enacted were not subject to the summary power of a court of bankruptcy. They did not become subject to such summary jurisdiction after the Act took effect. Indeed, the failure of Congress to amend the reorganization sections of the Bankruptcy Act, when the Investment Company Act was passed is persuasive that it was not intended that those sections of the Bankruptcy Act, so ill-adapted to the processes of reorganizing a face-amount certificate company, would be resorted to as the basis for such summary jurisdiction.

When consideration is given to the clear intent of Congress to leave the existing deposits undisturbed, it would not be consonant with justice to arrive at the result aimed at by the petitioners by resort to any forced or strained construction of the provisions of Chapter X of the Bankruptcy Act.

The reason that we insist that the question of the rights of contract holders in the State deposits is *crucial* is that the disposition of the question of the want of power in the Bankruptcy Court to avoid the State deposits will leave the Debtor with practically no property that can be made the basis of a reorganization. As soon as this question is determined—as it seems to us that it must be against any power in the Bankruptcy Court to abrogate or cut down the State deposits—the dismissal of the petition is required.

PROCEEDINGS IN STATE COURT IN TENNESSEE.

The transcript of the proceedings in the Chancery Court of Davidson County, Tennessee, filed as an exhibit to the answer of the defendants to the Debtor's petition for reorganization shows that prior to the time the petition was filed, a suit was pending in the State Court to subject the deposit in Tennessee to the satisfaction of the claims of contract holders entitled to the benefit of deposit in that State. The deposited securities were then being held by the State Treasurer in pursuance to the statutes of that State, making him the Custodian of the deposit. By decree of the Chancery Court he had been enjoined from disposing of the deposit in any way except under orders of that Court. The time had been fixed for the filing of the claims of creditors and many claims had already been filed. Since that time many other claims have been filed. The time expired on November 1, 1941.

But for the injunction or stay in the order of August 9, 1941, the Tennessee State Court could have proceeded with the distribution of the deposit in Tennessee after November 1, 1941. *The Debtor has no equity in the Tennessee deposit.* (Original Transcript, p. 225)

By reason of these facts, the deposit in Tennessee cannot be affected in any way by any attempt to reorganize the Debtor except by delaying distribution. Even if there is an attempt to effect a plan of reorganization, any plan of reorganization must give the Tennessee contract holders the option of obtaining satisfaction of their entire claims out of the deposit in Tennessee. This deposit under the laws of the State cannot be withdrawn until the discharge in full of all claims of Tennessee contract holders. Since in Tennes-

see the Insurance Commissioner is prevented by statute from giving an investment company a license to do business unless it maintains a deposit of 100% of the amount of its cash liabilities to the holders of investment contracts sold in the State, there can be no sealing down *in invitum* of the claims of contract holders against the deposit so as to free any of the deposited securities for use in equalizing deficiencies in other States or to furnish working capital.

Respondents duly moved to vacate and set aside the stay order made by the District Court so as to permit the Chancery proceedings in the State Court to be prosecuted. Their motion was overruled by the District Judge. The Court of Appeals correctly envisaged the situation with respect to the State deposits generally, and concluded that it would be unjust and unreasonable to these contract holders to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained.

PROCEEDINGS IN STATE COURT IN MISSOURI.

It is to the Missouri deposit that the Missouri contract holders must look for payment. The Commissioner of Securities in Missouri required the Debtor corporation, as a condition to the right to do business in that State, to deposit in trust for the benefit of Missouri contract holders securities equal to the amount of outstanding liabilities in that State. Prior to the appointment of the State Court receivers and prior to the filing of the petition for reorganization, the Attorney-General for the State of Missouri, on the information of the Commissioner of Securities, instituted a proceeding in the Missouri State Court and obtained the appointment of a receiver.

When the Missouri contract holders purchased their contracts, they were led to believe (as shown by Exhibits 37, 38, 39, 40, 85, 86 and 87) that they need look no further than the Missouri deposit for their protection, in payment of their contracts. The question with them is, when are they going to get their money? None of them would have turned his money over to Fidelity if he had contemplated the slightest possibility of the deposit in his State becoming involved in protracted and expensive litigation in a Federal Court nearly one thousand miles distant.

The deposit in Missouri is not substantially in excess of its liabilities to residents of Missouri, if at all. The finding of the Circuit Court of Appeals that there was no substantial showing that surpluses existed in any State other than West Virginia (Tr., p. 261) is not challenged.

The Missouri contract holders are not concerned with the deposits in the State of Maryland or in Tennessee or in West Virginia, or in any other State which required deposits for the protection of contract holders in that State. They have no purpose to deprive any other State of any of the benefits of deposits made therein in accordance with applicable laws and regulations of the several Insurance and Securities Commissioners. The claim of the average contract holder is of a small amount. They can see nothing but injustice to the contract holders in any scheme or plan that has for its purpose the handling of all claims of all contract holders in the State of West Virginia, regardless of the State in which the contract holders reside.

STATE DEPOSITS CONSTITUTE PROPERTY HELD ADVERSELY TO BANKRUPT ESTATE.

While there are no decisions in Tennessee on the legal rights of contract holders arising from the deposit of securities by investment companies in that State, there is a plain analogy to deposit of securities by insurance companies. In *Pennebaker v. Tomlinson* (Cooper's), 1 Tenn., Chy., 111, it was held that the Tennessee law requiring a deposit of bonds by an insurance company doing business in the State was equivalent to a statutory mortgage for the benefit of all citizens of the State having risks. *The Tennessee statute, in compliance with which Fidelity made the deposit, is so plain that it needs no construction.*

In *Davis v. Amra Grotto M. O. V. P. E. R., Inc., et al.*, 169 Tenn., 564, 89 S. W., (2d) 754, 106 A. L. R., 1506, petition to rehear denied 170 Tenn., 19, 91 S. W. (2d) 294, 106 A. L. R. 1506, in which funds belonging to an insolvent foreign insurance company, domesticated in Tennessee, were impounded by a general creditors bill in the State courts, the Supreme Court of Tennessee declared the public policy of the State of Tennessee as follows:

> "It has long been the public policy of this state, declared through the decisions of this court, to retain within the state all assets of foreign corporations found within the state, and upon the insolvency of such corporations, to treat these assets as a trust fund, and to distribute them ratably among creditors. This is a sovereign right possessed by the state, consistently exercised, and one which we will protect and enforce."

The above case does not involve a statutory deposit for the benefit of residents of the State of Tennessee. There

can be no question but that by virtue of the statute requiring the deposit of foreign investment companies, as a condition to doing business in the State of Tennessee, the deposit of securities rendered them subject to process within the State.*

Since the Trustee in Bankruptcy is not a purchaser for value, but stands in the shoes of the Debtor, it can assert no right having precedence over the lien which the Tennessee contract holders acquired.

This Court, on January 5, 1942 (which by a rare coincidence was the same day on which the District Judge rendered his opinion in the case at bar) denied *certiorari* in the case of In Re Mt. Forest Fur Farms of America, Inc., (6 C. C. A.), 122 F. (2d) 232, 314 U. S., 701, 62 S. Ct., 480, 86 L. Ed., 561. The Sixth Circuit Court of Appeals in its opinion said:

> "Neither exclusive jurisdiction of the debtor nor power to issue process outside the district confers upon the bankruptcy court the power, in a summary proceeding, to decide, without the consent of an adverse claimant, a controversy concerning property in his possession, unless his claim be merely colorable. Were it otherwise, every *bona fide* possessor of property held adversely to a bankrupt could be haled into a distant Federal Court to defend his right to the property when-

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*In *E. & J. Northman, etc., v. Liverpool, London and Globe Insurance Company*, 1 Tenn. Chy., (Cooper's) 312, the Court said:

"But if it be conceded that the demand is purely legal, the fact that the insurance companies are non-residents, and that there is a *trust fund* in the hands of their co-defendant, the state comptroller, deposited by the companies for the express benefit of such claimants as the complainant alleges he is, is sufficiet to give the court jurisdiction."

Cf. *United States v. Knott*, 298 U. S., 544, 56 S. Ct., 902, 80 L. Ed., 1321, 104 A. L. R. 741.

ever the trustee in a reorganization proceeding should choose to corral him summarily."

The authorities on the question convince us that the adverse claims to the various State deposits may not be disposed of summarily as the District Court undertook to do. A summary determination of these substantial claims arising under State laws, the validity of which is in no way questioned in this proceedings, seems to us to run squarely contrary to the principles announced by the Circuit Court of Appeals for the Fourth Circuit in *Warder* v. *Brady*, 115 F. (2d), 89.

This view also has the support of *Dannel* v. *Wilson-Weesner-Wilkinson Company*, 109 F. (2d), 364, another decision by the Circuit Court of Appeals for the Sixth Circuit. The question there was whether or not the retainage in the hands of the Commissioner of the Department of Highways of the State of Tennessee which was reserved by statute for the benefit of unsatisfied laborers and furnishers of materials on State highways, and which was in the custody of the State and was to remain until the debts of the contractor in the construction of highways were satisfied, constituted property of the bankrupt. There, as here, the right to administer the fund was in issue. There was no surplus belonging to the bankrupt. The Court said:

> "He retained the fund under authority of the statutes of Tennessee and the decree of the Chancery Court for such parties as would be found entitled to it, among which were parties claiming adversely to the trustee. We have held that where a fund is in the possession of a legal custodian for claimants who are asserting rights adverse to those of the trustee in bankruptcy, and they,

in accordance with law, invoke the aid of a proper State Court to perfect and enforce their lien, that they are adverse claimants. In re Farrell, 6 Cir., 201 F. 338; In re Rohrer, 6 Cir., 177 F. 381."

Neither the Investment Company Act nor any other Federal statute confers any power upon a Federal Court sitting in bankruptcy to avoid the deposits of the Debtor made in the various States because: (a) whereas the amendment to the Bankruptcy Act (Sec. 67 (f)) does confer power to require State deposits to be turned over to the trustee, this power is *limited* to deposits for the benefit of the holders of securities sold *on or after January 1, 1941*; and, (b) no power was conferred upon the Trustee to use the turned-over deposits for any purpose except *liquidation and distribution* of the net proceeds thereof to creditors entitled thereto under the provisions of the law or agreement providing for the deposit. (Sec. 67 (f) (3))

There has been no suggestion of any invalidity of any of the State statutes regulating the investment companies in pursuance to which the deposits with State officials were made. It is merely contended that all of these precautions which the States took for the protection of the investors in these companies against the day when there might be some failure on the part of the companies to meet their obligations, *now that that day has arrived, must be held for naught.*

Surely no court of equity would countenance for a minute such an attempt to undo the valid and salutary safeguards thrown up by the States to protect their citizens against the disaster which has come, except on grounds of a clear viola-

tion of some express prohibition in the Federal Constitution against State legislation of such character. Seven years have elapsed since Securities & Exchange Commission commenced its study of these companies, and no suggestion that the States did not have the power to require this protection for their citizens has yet been made, *by anyone*, so far as we know.

INVALID STAY OF TENNESSEE PROCEEDINGS.

But for the injunction or stay in the order of August 9, 1941, the Tennessee State Court could have proceeded with distribution of the deposit in Tennessee after November 1, 1941, the time fixed for filing claims. These respondents, on September 15, 1941, filed in the District Court a motion to modify this order so as to permit the State Court to proceed with the distribution. (Tr., pp. 128-130) The District Judge reserved decision on this motion until his decision on the issues raised on the good faith hearing. His order sustaining jurisdiction overruled all the motions for dissolution of the injunction "freezing" the deposits in the hands of the State depositaries. (Tr., p. 202)

Respondents prayed a broad appeal and in their brief before the Circuit Court of Appeals assigned error on the action of the lower Court in overruling their motion for modification of the injunction. Inasmuch as the Circuit Court of Appeals held that jurisdiction in the lower Court was entirely lacking, there was no express ruling on this motion. The order of the Circuit Court of Appeals staying mandate pending the application to this Court for *certiorari* modified the District Court's order of August 9, 1941 in several respects. For one thing, it authorized the sale of securities by the State Courts. It authorized the State

Courts to proceed with the necessary administrative work looking towards the future distribution of the funds with the exception that no actual distribution should be made. (Tr., pp. 268-270)

The Tennessee respondents respectfully insist that the stay order proceedings in Tennessee looking to distribution of the State deposit was invalid and beyond the power of the Bankruptcy Court in this case.

There is an utter failure of the proof to show any reasonable likelihood of effecting a plan of reorganization which will either (a) require the use of the Tennessee deposit, or (b) by which Tennessee contract holders could be lawfully deprived of their option of obtaining cash out of the Tennessee deposit to the extent of the full amount of their respective claims.

The writ of injunction, when exercised to stay the rights of secured creditors during the pendency of reorganization proceedings, cannot be exercised beyond the dictates of necessity. *Continental-Illinois National Bank & Trust Co.,* v. *Chicago, Rock Island, & Pacific Railway Co.,* 294 U.S., 648, 55 S. Ct., 595, 79 L. Ed., 1110; In Re Nine North Church Street, Inc., 82 F. (2d), 186; *First National Bank of Wellston* v. *Conway Road Estates Company,* 94 F. (2d) 736, (8th C.C.A., *Certiorari* denied by U. S. Supreme Court, 304 U. S., 578, 82 L. Ed., 1541; *Lincoln-Alliance Bank & Trust Company* v. *Dye,* 115 F. (2d), 234.

As regards the deposit in Tennessee (and as for that matter all of the other State deposits) possession was not in the bankrupt at the time of the filing of the petition and the Bankruptcy Court has never acquired either actual or constructive possession of the deposits. In Tennessee, at

least, the sustaining of the bill in the Chancery Court of Davidson County impounding the State deposit prior to the commencement of the proceedings in bankruptcy gave that Court prior and constructive jurisdiction of the *res*, the deposit, and, therefore, the exclusive power to settle the controversies concerning it without being subjected to a stay of such proceedings by the Bankruptcy Court. *Dannel* v. *Wilson-Weesner-Wilkinson Company*, 109 F. (2d) 364, (6th C.C.A.); *Hoehn* v. *McIntosh*, 110 F. (2d), 199, (6th C.C.A.).

The nation-wide jurisdiction conferred upon bankruptcy courts by Section 77-B and in proceedings under Chapter X of the Chandler Act is merely over the property in possession, actual or constructive, of the Debtor or the Bankrupt Court. This summary jurisdiction is essentially in *rem*, and while it enables the Court to issue its process for service outside of its district, in a summary proceeding relating to the *rem*, it does not extend to the persons of non-residents who claim the property adversely. *Warder* v. *Brady*, 115 F. (2d) 89, (4th C.C.A.); *In Re Standard Gas & Electric Co.*, 119 F. (2d) 658 (C.C.A., 3rd); *Kelso* v. *MacLaren*, 122 F. (2d) 867, (8th C.C.A.); *In Re Mt. Forest Fur Farms of America, Inc.*, 122 F. (2d) 232 (6th C.C.A.) (*Certiorari* denied, 314 U. S., 701, 62 S. Ct., 480, 86 L. Ed., 561.)

We respectfully submit that the authorities afford no basis for any power in the United States District Court for the Southern District of Virginia to dispose of the claims of all of the contract holders to the various State deposits summarily as the Court said that it had done and would do if necessary.

A PETITION MAY NOT BE FILED UNDER CHAPTER X AND SUSTAINED FOR PURPOSE OF LIQUIDATION.

Since petitioners and Securities & Exchange Commission makes the question of jurisdiction turn chiefly on the prospect of a "slow and orderly liquidation," it is necessary to discuss whether or not a plan of liquidation may be a plan of reorganization which will confer jurisdiction upon the Bankruptcy Court. This discussion may be begun by the observation that if Congress had intended to include "liquidation" there was no reason why that word could not have been used in Chapter X, along with "reorganization." *The two terms as commonly understood are contradictory.* And yet, invariably the word "reorganization" is used.

The Court is not authorized to retain jurisdiction unless there is a finding that the petition is filed in good faith, meaning, among other things, that it is not unreasonable to expect that a plan of *reorganization* can be effected. If not so satisfied, it is the duty of the Court to *dismiss* the petition. (Section 144)

If "reorganization" includes "liquidation," why the requirement of a showing that it was not unreasonable to expect that a plan could be effected? A plan of liquidation can always be effected. That is the last resort. If the imperative requirements of Sec. 146 of Chapter X, the heading of which is CORPORATE REORGANIZATION, are to have a natural and reasonable interpretation, liquidation must be excluded. In Sec. 130(6) Congress differentiated between a reorganization and a liquidation.

It is only after a petition has been sustained as having been filed in good faith and it develops that a plan of reor-

ganization cannot be put into effect, that the power is conferred upon the Court to decide between adjudging the Debtor a bankrupt and directing that bankruptcy be proceeded with or dismissing the proceedings altogether. (Section 236 (2)) This may not be done without a *hearing expressly for that purpose* and after notice thereof to creditors.

The provisions of the Act are not susceptible of the construction that an affirmative finding of a reasonable likelihood of reorganization may be dispensed with by a finding that some kind of liquidation in the Bankruptcy Court would be better than a liquidation in State courts, or otherwise. The Act permits no escape from the issue which is raised at the very threshold of the litigation—is there a reasonable likelihood of *reorganization*.

The creditors of Fidelity had no notice of any hearing on the question of whether it should be adjudged a bankrupt in the Southern District of West Virginia and an order entered in that Court directing that bankruptcy be proceeded with there. They had notice, actual or constructive, that the Company had filed a petition for reorganization and that there would be a hearing on that question. Section 146 (4) does not extend the scope of the normal hearing on the issue of good faith. Creditors had the right to assume that if this requirement of good faith involving necessarily a reasonable likelihood of effecting a plan of reorganization, could not be met, the mandatory provision of Section 144 that the petition be dismissed would be complied with by the Court.

In the ordinary case, there would be no occasion for the Court looking ahead of the considerations normally to be weighed in determining whether there is a reasonable chance of reorganization. The proponents of reorganization are

bent on showing how the rehabilitation of the company can be effected. Those who feel that it is not to their interest that the company be revived and its business continued adduce facts and arguments to show why reorganization cannot be brought about. If the petition for reorganization is dismissed, the company can ordinarily immediately file in the *same* court a petition to be adjudicated a bankrupt. So, at that stage of the proceeding, there is no necessity for any concern about what will happen to the company if the petition for reorganization is not sustained.

The difference between the ordinary case and this is that unless the petition which has been filed can be sustained as a petition for reorganization under Chapter X, *territorial jurisdiction in the District Court for the Southern District of West Virginia is lackng.*

Section 128 permits the filing of a petition for reorganization under Chapter X with the Court in whose territorial jurisdiction the corporation has had its principal place of business *or* its principal assets for the preceding six months or for a longer period of the preceding six months than in any other jurisdiction.

A petition for an adjudication (in what is commonly called ordinary bankruptcy proceedings) may be filed only where th corporation has had its principal place of business. Section 2, Bankruptcy Act. There is no territorial jurisdiction in the Court merely because the principal assets of the company have been in that jurisdiction for six months.

The principal place of business of the Debtor corporation has always been at Wheeling, West Virginia, in the Northern District of West Virginia. The petition was filed, how-

ever, at Charleston in the Southern District on the theory that the deposit with the State of West Virginia constituted the principal assets of the Company.*

If Fidelity is not an insurance corporation and is subject to the Bankruptcy Act, a voluntary or involuntary petition can be filed at Wheeling where its office and all of its records are located. It can be liquidated in bankruptcy without indulging in the sophistry of *calling* a liquidation a reorganization.

Lord Macauley somewhere says that if the admission of the attraction of gravitation were inimical to any considerable pecuniary interest, there would not be wanting arguments against gravitation. Twenty million dollars is enough money to stir men's imagination.

Away with the vauntings of the disinterestedness of the Trustee in Bankruptcy in this case! Let us make it plain. If this Court affirms the decision of the Court of Appeals dismissing this petition for lack of good faith, it means that the present Trustee loses its chance to derive fees from the distribution of the assets of this company. Even if the company is held not to be an insurance company and should be adjudged a bankrupt, the adjudication would be in the Northern District of West Virginia and a Trustee in that District would be appointed. The present Trustee is a corporation organized for profit—not an eleemosynary institution. *How can it claim to be disinterested on the issue of good faith?*

*It seems to us that this premise is unsound. The deposit in West Virginia constituted a statutory trust fund. Inasmuch as the fund was less than the liabilities secured and the Debtor in this and in no other kind of proceeding, either in the Federal or in the State Court, can take any part of that fund away from the contract holders for whose benefit it is held, without their consent, it does not constitute "assets" of the Debtor.

"PROBLEMS OF DISTRIBUTION."

(i) Whether State Deposits Are Solely for Benefit of Local Residents.

Securities & Exchange Commission in its brief says that under the laws of the State of Tennessee it is not clear whether the deposit is solely for the benefit of local residents or for the benefit of all contract holders. It has gotten up an appendix purporting to set out State laws. Through inadvertence one whole paragraph from thte Tennessee statute was not copied in this appendix. The whole statute was printed in our brief filed in the Court of Appeals and was also printed as Appendix "A" to our reply to the petition for *certiorari* in this Court.

We submit that there is no ambiguity in this statute. It clearly provides that the amount of the deposit is to be at no time less than one hundred per cent of the Company's cash or current contract liability on all outstanding investment contracts "sold in the State of Tennessee." It provides that the Commissioner of Insurance and Banking of the State shall hold as Custodian the securities deposited "for the benefit of the holders of the investment contracts coming within the provisions of this Section. The omitted paragraph contains the following provision:

> "Upon discharge in full of all liabilities on all investment coatracts sold in the State of Tennessee, and for which such deposit is maintained, the issuer shall be entitled to a release and return of the securities so deposited."

Plainly, this deposit is for the benefit of the holders of all investment contracts sold in the State of Tennessee.

We are constrained to feel that Securities & Exchange Commission has been needlessly perturbed. It overlooks the fact that the deposit in West Virginia was for the benefit of all contract holders wherever situated. The amount of the deposit required in West Virginia was the full amount of the liabilities of the corporation under its contracts, less such additional deposits as it was required to make with respect to contracts sold in other States to the extent that the law of such other States required deposits to be made for the benefit of local contract holders. A reading of the proviso contained in Section 3 of Article 2, Chapter 33, Michie's 1937 West Virginia Code, on page 71 of the brief of petitioners, Fidelity Assurance Association and Central Trust Company, would clarify this point.

Securities & Exchange Commission, in the appendices to its brief, has seen fit to insert a lot of extraneous matter, contracts, etc., with other State officials that are not in evidence in this case. We, therefore, cannot admit the accuracy or completeness of this extraneous matter.

We do not believe that there is the slightest ground for apprehension that contract holders in other States will claim the benefit of local deposits. All parties, except the Securities & Exchange Commission, understand that non-residents of a State having a local deposit are not beneficiaries of that deposit unless they can claim through some express statutory provision (such as the one in Tennessee securing all contracts *sold* in the State of Tennessee). The exceptional cases where contract holders have changed their residence after the creation of deposit, and such like, fall under the head of *de minimis non curat lex*. See discussion under next head.

"PROBLEMS OF DISTRIBUTION."

(ii) Time for Determination of Residence of Contract Holders Entitled to Benefit of Deposits.

It must be admitted that as Securities & Exchange Commission has delineated this question, it takes on an appearance of complexity. Securities & Exchange Commission cites pages 757 to 758 of the transcript. If it had not stopped there but had gone on to page 759, it would have found that Mr. F. J. McNulty, the Secretary of the Company, testified that this was no problem. We quote his testimony as follows:

> "Q. Would there be many states in which there was a considerable number of contract holders who did not buy their contracts or originally in this state but who now own the contracts and reside in those states?
>
> A. Well, if you take, say, two specific states, I would say no, but if you are talking about moving out of one state there might be fifteen or twenty more throughout the United States, but as to a change from one particular state to another particular state, *I don't think the change would amount to very much.*
>
> Q. Then if all that was required under the law in some of those states was that the company only deposit securities that were in funds that were sold in those states, and the debtor decided to withdraw the securities over and above those that were sold only in those states, would there be much withdrawal or would it be a very small figure?
>
> A. Well, I couldn't answer that. I would have to check that. (Tr., p. 759)

Q. You wouldn't be able to answer it?

A. *It wouldn't be a substantial figure*, but it would have to be checked."

"PROBLEMS OF DISTRIBUTION."

(iii) Measure of Claims.

The proposition, as we understand it, is that the Federal Court in Bankruptcy at Charleston, West Virginia, must take over the deposits in West Virginia and fourteen other States in order to bring some superior competency to bear on the question of the basis for the determination of the claims of the contract holders entitled to the benefit of the several deposits. Manifestly, if the State deposits are not to be abrogated, the Bankruptcy Court will be bound by the laws of the several States. Certainly there is no Federal rule which can be applied. The Tennessee contract holders will be thoroughly satisfied to let the Tennessee Court determine that question if any is raised. So will the Missouri contract holders. So, we believe, will be the contract holders in all of the other States.

It is admitted that there is no possibility of a surplus in the Tennessee deposit regardless of which of the possible rules may be applied in Tennessee. The entire deposit will be consumed in paying the claims of Tennessee contract holders. What interest do contract holders in other States, then, have in the basis for distribution which is adopted in Tennessee? The West Virginia Court distributing the West Virginit deposit can make its own decision as to the basis for deficiency claims in accordance with the laws of that State. Even though the rule in West Virginia be different from the rule in Tennessee, or one of the other States, we fail to see how it will be more beneficial to con-

tract holders to have the question decided by the Federal Court in Bankruptcy at Charleston than by the Circuit Court of Kanawha County, at Charleston.

We are wondering why it appears strange to Securities & Exchange Commission that there is little inclination among the State officials to litigate these so-called conflicting rights *inter sese*.

STATES CAN LIQUIDATE DEPOSITS AS WELL AS BANKRUPTCY COURT.

The argument that liquidation in the Southern District of West Virginia at Charleston will result in a more orderly marketing of the securities held in the State deposits does possess a certain plausibility. Here again, however, an examination of the record discloses the speciousness of the argument.

There is not an iota of proof in the record to support the statement that Fidelity's assets are such that there is a serious peril to a maximum realization upon them if each State depositary separately proceeds to immediate liquidation. The record (pp. 799-800) is cited in support of the statement that the situation is plainly one which requires well-timed and skilful liquidation. It is true that the District Court found this, but his finding was not based on any evidence. The evidence cited in support of the statement is the testimony of Mr. Hubert F. Young, a witness for the Debtor and the Trustee, who handled Fidelity's investments.

Mr. Young testified that it would take "quite a while" to liquidate and said that it might drive the market down to the bottom when liquidation started. He expressed more concern, however, about the expense of litigation and the

uncertainty as to what the state of the market would be after years of liquidation.*

This wasteful litigation and postponement of the realization of the present market values of the securities is exactly the thing that the contract holders are so disturbed about and is what these respondents are protesting. (Tr., pp. 799-800.)

The Securities & Exchange Commission makes use of the Trustee's report filed under Section 167 of the Bankrupt Act. It deduces from this report that Fidelity's securities are not readily marketable. (Brief, p. 44.) This conclusion is derived from some kind of system of rating of securities. In candor, these respondents must say that their attorneys are not thoroughly familiar with the basis which was used for this report of the Trustee.** The conclusion that a large part of the securities in Fidelity's portfolio are not readily marketable may not be drawn from the fact that they all have been classified by the Trustee as high-grade securities.

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*A most significant portion of his testimony is:

"Q. If you will assume with me that there are some twenty million dollars of assets in this company, or better than that, which could be be distributed among contract holders on the basis of their cash surrender values at the present time—cash liabilities at the present time—of about twenty-three million dollars, they could get that amount out of liquidation if you just sold them out and distributed the money, couldn't they?

A. I doubt it, after years of liquidation expense and the expense of litigation I don't think they would get anything like twenty million dollars."

(Tr., p. 799)

**The time for filing this report was extended by the Judge until the conclusion of the testimony. The Judge also ruled that those at odds with the Debtor and the Trustee could not cross-examine on the report. That portion of the record where this ruling was made (Tr., pp. 3008-3012) was not included in the designation of the portions of the typewritten record to be printed for the transcript. We are printing this in the Appendix to our brief.

The Report of Securities & Exchange Commission on *Companies Issuing Face-Amount Installment Certificates*, transmitted to Congress on March 13, 1940, states: "The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about ninety per cent of which have consisted of bonds and notes." (Page 96 of Report.)

The Central Trust Company, Trustee in Bankruptcy for Fidelity, under date of July 3, 1941, sent out a circular letter to all contract holders stating that the property of the Debtor was "almost entirely in the form of *liquid assets*, composed of stocks, bonds, and other forms of securities."

The Haskins & Sells audit reports, filed as Exhibits 13 and 14, show the diversification of the investments and the amount of defaulted securities. We do not believe that the amount of bonds in default is abnormal for a port folio such as Fidelity had. For example, many railroad bonds, at the time these audit reports were prepared were in default, are readily marketable and indeed may be termed highly liquid.

Mr. Hubert F. Young further testified as to the character of the investments:

"Q. And has there been any appreciable change in the assets of Fidelity from 1939 to the present time?

A. I would say not an appreciable gain on a percentage basis, no.

Q. As a matter of fact, there has been considerable appreciation in the past two months, hasn't there, in the value of the securities in the port folio?

A. Yes, in certain categories, for instance, railroad bonds.

Q. What do you think about the possibility or probability of appreciation in the value of securities during the next two or three years ahead of us?

A. I think we have an excellent change of appreciation on the type of port folio we have, which consists largely of, you might say semi-speculative bonds and not a great many of the higher grade bonds, which can, I think, go down quite a bit."

(Tr., p. 633.)

This testimony was given in September, 1941. Subsequent events have borne out Mr. Young's prediction. This Court may take judicial knowledge of the fact that prices of the semi-speculative bonds are at a very high level as compared with the averages in past years. There probably has never been a better time than the present to liquidate securities of the type held in the State deposits. No one knows what the future will bring forth. It will take time—too much time—for the several States to complete liquidation. There need be no dread of frenzied dumping of the securities on the market.

The Securities & Exchange Commission was not warranted in stating that the market for these securities is so thin that when they are sold by the States the price will be greatly depressed. The investments are widely diversified. The investment market has recently indicated a practically unlimited capacity to absorb offerings of Government bonds. We have witnessed an almost phenomenal absorption of more than nine billion dollars in a single offering of Government securities. Surely Fidelity's little portfolio of twenty million dollars would not bring about any very marked de-

pressing effect upon the bond market, even if all of the bonds were offered at one time for sale as a whole.

It would seem to us that offerings at different times and in the different sections of the country in which the State deposits are held will be more likely to result in an orderly marketing of the securities than any kind of liquidation that could be attained if the selling is all centered in the hands of one Trustee. Contract holders are afraid that if the latter occurs the liquidation will be stretched out over such a long period of time that no benefit will flow from it in the lifetime of most of them.

POSTPONEMENT OF LIQUIDATION FOR FURTHER INVESTIGATION OF FIDELITY'S AFFAIRS WILL BE PREJUDICIAL TO CONTRACT HOLDERS.

It is the conviction of the contract holders for whom we speak that the day for probing into Fidelity's affairs has passed. They have in mind an old adage to the effect that there is no use barring the door after the horse has gone.

We are reminded, however, that during the last half decade and longer there has been no hindrance upon investigations and explorations of Fidelity. During that period its books have been open to Securities & Exchange Commission.

Part One of the Report of Securities & Exchange Commission on Investment Trusts and Investment Companies informs us that the investigation of the face-amount certificate companies was commenced on June 30, 1936, when questionnaires were sent out to the companies. It could hardly be said that this questionnaire was limited in it's scope. (See Statement in Part One of Report on the Na-

ture, Classification and Origin of Investment Trusts and Investment Companies, p. 8.)

The Commission's Report on Companies Issuing Face-Amount Installment Certificates states that the first public examination into Fidelity's affairs was had on January 28, 1938. In the last month of the year 1938, Securities & Exchange Commission filed its bill in the United States District Court for the Eastern District of Michigan. The particulars of the proceedings against Fidelity, set out in Appendix X to the Report on Companies Issuing Face-Amount Installment Certificates (pp. 197 to 258), indicate that Securities & Exchange Commission was not wholly unfamiliar with the various things that Fidelity had been doing and which constituted the basis for the charge of wrongdoing and fraud. Chapter 3 of that Report, which embraces pages 75 to 120, inclusive, and the other details in Chapter 5 and the appendices relating to Fidelity, set out a considerable amount of detailed information concerning Fidelity.

Not all of the information which Securities & Exchange Commission compiled was set out in its printed report either. A lot more was contained in Fidelity's reply to the Commission's questionnaire. This consisted of several large volumes. These were produced at Charleston during the course of the hearing pursuant to an order made by Court at respondents' request. As we recall, they were about knee-high.

Immediately following the Detroit injunction, there came the suit in the Federal Court in the Northern District of West Virginia to have a Receiver appointed for the Company. During the receivership proceedings two Commission accountants were constantly around and stayed there

until the receivership matter had been determined. (Tes. of Thos. B. Folk, Tr., pp. 939-940.) The Commission has had a perfect legal right to carry on its investigations without interruption since it first commenced nearly seven years ago. More than a year and a half has already passed since Fidelity's books and records came into the hands of the Trustee in Bankruptcy.

The record shows that no single major step has been taken since that time without at least tacit approval of the Commission. The Commission has been consulted on all of the things done to rehabilitate Fidelity, including its conversion into an insurance company. The testimony of Mr. John Marshall, Mr. Fred Risley, Mr. Thomas Foulk, Mr. Raymond Latta and Mr. Arthur B. Koontz makes that perfectly plain. The officers of Fidelity were in practically constant communication and consultation with them.

The insinuation of some sinister motives in connection with the proceedings in the Kanawha Circuit Court and the connection of Mr. Koontz' firm therewith have been put to the forefront as point No. One. It deserves no place in this lawsuit. In this respect we have the assurance that we speak the views of all parties in interest who are opposing this reorganization proceeding: it is a matter of absolute indifference to these parties whether Koontz & Koontz or Townsend & Townsend are to be the attorneys for the liquidators of Fidelity.

It may be said in Mr. Koontz' favor that the record shows with perfect clearness that the appointment of Mr. Ross Thomas, an associate of his firm, as co-Receiver of Fidelity, was not obtained through obreption but was with the full approval of all interested parties who now are disposed to

criticize it. We are afraid that the greatest offense which he committed was, in the eyes of Securities & Exchange Commission, advising State instead of Federal proceedings. The decision that the Company's affairs should be placed in a receivership in the State Court, however, was openly arrived at and was attended with the greatest deliberation, with full opportunity to all interested parties to express their views. It occurred in a Court located at the place where Mr. Koontz and Mr. Thomas lived and which was the proper and natural forum therefor.

It seems to us that the leaving of the important, nay crucial, question of the rights of contract holders in the State deposits undetermined and magnifying instead trivial and unimportant considerations, such as this one, is "straining at a gnat and swallowing a camel." The inquiry (assuming, as is shown by the record, at times the character of an inquisition) into the relationship of the firm of Koontz & Koontz and Mr. Ross B. Thomas to the Debtor and its affairs, which the defendants steadfastly insisted was extraneous and irrelevant to the issue of good faith in this case, apparently in the mind of the Court was a point of major importance.

During the hearings before the District Judge in this case, altogether several hundred pages of testimony were taken, over the objection of respondents that it was irrelevant, about nothing except the amount of fees which Koontz & Koontz had been paid by Fidelity over a ten-year period. Respondents feel compelled to state that the District Judge, sitting in a Court two hundred miles away from the home office of the Company where all the company's records were located, and in a Federal District outside the District in which the receivership suit had been brought in 1939, mani-

fested an inclination to allow the attorneys for the Trustee whom he had appointed an opportunity to conduct an "exploration" that was very far afield. This matter was the subject of an exchange of letters between the District Judge and the Judge in the State Court. (Original Transcript of Record, pp. 131-133.)

We feel that it was very unfortunate that the rights of contract holders in Tennessee and in the other States where deposits are being held should have depended in the slightest degree upon such a collateral inquiry. The jurisdiction of a court in bankruptcy to entertain this proceeding for reorganization of Fidelity most certainly should not turn upon weighing the ethical standards of Koontz & Koontz as against those of Townsend & Townsend.

There is an ancient maxim "*Executio juris non habet injuriam*," meaning "the law will not in its executive capacity work a wrong." A lack of integrity or competence to make decisions or to execute powers is never assumed in regard to Courts in this land. On the other hand it is a fundamental assumption that Courts are sound and just.

A Federal Court would, therefore, not be warranted in assuming that a State Court would in its executive capacity work a wrong. If we assume, for the sake of argument, that the record in this case warrants the conclusion that it would not be to the best interest of creditors of Fidelity Assurance Association, for Mr. Ross Thomas to continue as a Receiver in the State Court, this works no disqualification of the State Court itself to serve the interest of creditors and in such proceedings to be guided solely by the dictates of justice.

The personal integrity of Mr. Ross Thomas is unquestioned. If there is any unsuitability on his part to be a Receiver in the State Court, there is no ground for this Court making any supposition that a proper and suitable correction will not be made by the State Court whenever its attention is challenged to the need therefor.

Judge Bouchelle, in his letter to Judge Moore, stated that he would not hesitate to perform his duty.

Securities & Exchange Commission, at page 33 of its brief, made reference to an indictment against Mr. Arthur Koontz. We have since been advised that the Office of the Solicitor-General admits that this was injected in the brief though a mistake. But still it is in there. We cannot refrain from expressing the opinion that Securities & Exchange Commission when it inserted this matter not only struck below the belt but went outside the record.

Something must be said about this attempt to weight the balances on the side of the Bankruptcy Court with scandal. The indictment referred to was obtained by Securities & Exchange Commission in Detroit, in December, 1941, (just before the statute of limitations would have run against acts committed prior to the filing of the injunction suit in Detroit) after the hearings in this case had been finished. Before the District Judge rendered his decision in this case, these respondents made a motion to have it made part of the record for the purpose of showing that Fidelity Assurance Association, the Debtor, was under indictment. We thought that this was relevant on the question of whether or not there was enough vestige of good will left to justify any expectation that contract holders would consent to send good money after bad. The District Judge overruled our motion and excluded the indictment.

The chief basis for the indictment seems to be a lot of the matter set forth in the report on Fidelity in the Report on Companies Issuing Face-Amount Installment Certificates. We believe that all the material facts were either printed in this report or known to Securities & Exchange Commission when it filed the complaint and obtained the injunction in Detroit, in December, 1938.

We are reluctant to set ourselves up as critics of other men's conduct. It does seem to us, however, that before urging this matter as a ground of disqualification of the West Virginia State Courts to serve the best interest of contract holders, Securities & Exchange Commission should give a thought to consistency. The Detroit injunction which Securities & Exchange Commission obtained on December 22, 1938, was granted by reason of misconduct. It enjoined not only Fidelity, but its officers, directors, agents, representatives and employees, from engaging in and continuing such practices which were alleged to be fraudulent. All of these persons were ineligible to serve or act in the capacity of officer or director, by virtue of the provisions of Section 9 (a of the Investment Company Act of 1940. According to the testimony adduced in this case by the Commission, Fidelity became a registered investment company under the Act, by giving notice prior to January 1, 1941, of its intention to register.

Securities & Exchange Commission has made no objection to any of them continuing to act. Its representatives did not join the respondents in protesting the ruling of District Judge granting express permission to all of these ineligible persons to have another meeting *while the hearings were in progress*, for the purpose of ratifying the previous action of

the directors authorizing the filing of the petition in this case. Mr. Koontz was not one of these persons.

It would seem that if the Kanawha Circuit Court of West Virginia could not serve the best interest of the contract holders of Fidelity because Mr. Koontz' firm had been appointed attorneys for the Receivers and one of his associates, Mr. Thomas, was a co-Receiver, neither was it proper for Fidelity to employ them before the receivership suit. Nor were Mr. Koontz and Mr. Thomas by themselves. On the same ground, the directors and officers—Mr. John Marshall, Mr. Fred Small-Risley, Mr. A. L. King, Mr. Carroll D. Evans and Mr. Howard E. Reed—named in the indictment ought to have been disassociated from the company.

Securities & Exchange Commission, as is shown by this record, worked very closely with all these men after the Detroit injunction. If it were wrong for Mr. Koontz and Mr. Thomas to have anything to do with the Company's affairs after the receivership, it was wrong for them and the officers and directors mentioned above to be connected with the company after December, 1938, and especially was it improper (unless Fidelity was an insurance company) for them to continue their connection after January 1, 1941, when the Investment Company Act became operative.

We think that Mr. Koontz and Mr. Thomas are honorable men. For that matter, we think that all of the gentlemen who testified at the hearing of this case are honorable men. As the Securities & Exchange Commission admits (Brief, p. 40) except for a brief period in 1937, Fidelity has been insolvent continuously since 1933. They were all fighting to save the contract holders from loss. There was a constant hope that some tide would lift Fidelity off the rocks.

One cannot read this record without being impressed with the fact that Mr. Koontz was the man on whom they all leaned in the darker hours. Even Mr. John Marshall, Sr., who, by the way, was Chairman of the Board of Directors and whose firm was general counsel for the company (Tr., p. 410), not only held Mr. Koontz in high esteem but depended on his support and guidance. (Original Tr., pp. 1140-1143)

When Fidelity could not comply with the Investment Company Act and it became apparent that some step of a rather drastic nature must be taken to avert disaster, it was Mr. Koontz who for several years past had been trying to raise new money for the company, that outlined before the Securities & Exchange Commission the plan of voluntary reorganization in the State Court which seemed then to all concerned to be the most feasible. We can see that Mr. Koontz had no choice but to stick by his friends. The fact that his firm was attorney for the Receiver was then no doubt regarded by Mr. Marshall, Mr. Messick and all of the other gentlemen as an asset and as furnishing the most likely presage of success.

There is nothing to indicate that Mr. Koontz and Mr. Thomas were actuated by any motive other than the welfare of the contract holders whose savings were tied up in this embarrassed company. Must we presume that they were concerned about stifling any investigations or concealing any liability after Securities & Exchange Commission had made a most thorough and searching investigation into the affairs of the Company and had printed its findings and made a report to Congress and to the public? Securities & Exchange Commission, in the year 1943, more than six years after its investigation of this company's affairs

was commenced, now says that the case ought to be in bankruptcy because there might be liability on the part of Mr. Koontz if there is substance to its charges.

Section 167 (4) of the Bankruptcy Act imposes the duty on the Trustee to report any facts ascertained by it pertaining to fraud, misconduct, mismanagement and irregularities and any causes of action available to the State. The Trustee in this case, which will not be charged with any misprision, so far as Mr. Koontz is concerned, has made no report against him.

We are advised that the Trustee, on April 13, 1942, filed Part Two of its report due to be made under Section 167 of the Bankruptcy Act. The Trustee stated in this report in substance that it was making a detailed study of the alleged irregular practices of former management rendering participants therein liable in damages but was unable to make detailed report concerning same. No further report has been made since that date.

In short, the Trustee, after a year and a half, aided by all of the data which Securities & Exchange Commission had accumulated during the previous five years, is unable to make up its mind whether or not it has a lawsuit. The fact that jurisdiction was unsettled was no hindrance to the performance of its duty in this respect. Let us suppose that it should finally decide that it has a probable cause of action. How many years will the case be in the courts before it is determined?

But if there need be further investigation, it doesn't depend on a decision in this case that the good faith requirement of Chapter X may be satisfied by a showing that the insolvent debtor can be liquidated in the Bankruptcy Court.

If liquidation occurs in the State Court proceedings, would there be interference with an investigation by Securities & Exchange Commission? If a cause of action exists, couldn't it be as effectually prosecuted in a straight bankruptcy proceeding at Wheeling, in the Northern District of West Virginia, where the office of the company and its records are located?

INAPPLICABILITY OF DOCTRINE OF MARSHALING —FIFTH AMENDMENT.

Apparently what the Securities & Exchange Commission has in mind when it speaks of marshaling the assets of Fidelity is an attempt to redistribute all the assets on the basis of separate reserve funds for the various series of contracts outstanding (Brief, p. 38). It is insisted that a prerequisite to the accomplishment of this Herculean task is bringing all of the assets into one forum.

It will have to be conceded that, if this were otherwise possible (and the evidence clearly shows that Fidelity did not keep separate records on the several funds until the latter years of its existence and the expert employed by it, Mr. Latta, after working eight months concluded that it couldn't be done—Tr., p. 1072), it would only be accomplished through an abridgement of the rights of contract holders having the security of the State deposits.

The argument is based upon a misapprehension of the doctrine of marshalling. The doctrine may not be invoked so as to impair the remedy of the holder of a prior lien or deprive a litigant of a contract right, nor even to put his claim in jeopardy nor to subject him to unreasonable delay in the enforcement of his claim.

In *Merrill v. National Bank of Jacksonville,* 173 U. S., 131, 19 S. Ct. Rep., 360, 43 L. Ed. 640, this Court approved a rule of the Chancery Court to the effect that:

> " . . . as the trust created by the transfer of the assets by operation of law or otherwise is a trust for all creditors, no creditor can equitably be compelled to surrender any other vested right he has in the assets of his debtor in order to obtain his vested right under the trust. It is true that, in equity, a creditor having a lien upon two funds may be required to exhause one of them in aid of creditors who can only resort to the other, but this will not be done when it trenches on the rights or operates to the prejudice of the party entitled to the double fund. Story, Eq. Jur. (13th ed.) Sec. 633; Re Bates, 118 Ill. 524 (59 Am. Rep. 383). And it is well established that in marshalling assets, as respects creditors, *no part of his security can be taken from a secured creditor until he is completely satisfied.* Leading Cases in Equity, White & Tudor, vol. 2, pt. 1, 4th Am. Ed., pp. 258, 322."

In *Sowell v. Federal Reserve Bank,* 268 U. S., 449, 45 S. Ct. Rep., 528, 69 L. Ed. 1041, Mr. Justice Stone delivered the opinion of the Court, saying:

> "The equitable doctrine of marshaling rests upon the principle that a creditor having two funds to satisfy his debt may not, by his application of them to his demand, defeat another creditor, who may resort to only one of the funds. The debtor may not ordinarily invoke the doctrine, for by doing so he would disregard the express provisions for his contract on which the creditor is entitled to rely. The plaintiff in error is bound to pay his obligation, according to its tenor. He

> cannot deny his own contract merely because his creditor has acquired other rights with which he may satisfy his debt. . . ."

The creditors in the case at bar having the security of the State deposits do not have two funds from which to obtain satisfaction of their debts. In the two or three States which have apparently one hundred per cent security, they have only one fund. In all of the other States, as in Tennessee and Missouri, that one fund is not sufficient. Neither the insolvent debtor, Fidelity Assurance Association, nor the Trustee in Bankruptcy, standing in its shoes, has any right to invoke the doctrine. Neither does any creditor have that right. None of them have any right to take away or abridge to the slightest extent the security which the Company put up in those States requiring deposits as a condition to the grant of a license to do business.

A fortiori jurisdiction does not exist in the United States District Court for the Southern District of West Virginia for the purpose of bringing all of the securities in the State deposits into that Court to enable an exploration or investigation to be made, with a view of some kind of re-shuffling of the deposits.

The Bankruptcy Act is subject to the Fifth Amendment. An Act of Congress which is retroactive in terms and purports to take away the rights of a mortagee in specific property is violative of the Fifth Amendment. *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S., 555, 55 S.Ct., 854, 79 L. Ed., 1593, 97 A.L.R., 1106.

Although a Bankruptcy Court, once jurisdiction has been acquired, may direct the marshaling of all liens upon prop-

erty forming a part of the bankrupt's estate, power to disregard the property rights created by State law is lacking. *Wright v. Union Central Life Insurance Company*, 304 U. S., 502, 58 S. Ct., 1025, 82 L. Ed., 1490.

After the States, in valid exercise of the police power, had enacted legislation requiring companies doing this kind of business to maintain deposits for the protection of its citizens, there was no power in the Federal Congress to abridge the vested property rights of contract holders in the deposits. As we have pointed out, Investment Company Act is prospective. Congress purposely refrained from enacting any legislation affecting the deposits made up to the effective date of the Act.

The argument of Securities & Exchange Commission that this Court should reverse the decision of the Fourth Circuit Court of Appeals and hold that the Bankruptcy Court has jurisdiction for the *avowed* purpose of abridging these vested rights of contract holders is tantamount to the insistence that through judicial fiat this Court may exercise a power which is denied Congress by the Constitution. Authority is not lacking for the view that the Fifth Amendment prohibits the judicial, as well as the legislative branch of the Federal Government, from depriving any person of his property without due process of law.

> "Individual citizens require protection against judicial action as well as legislative; and perhaps the question, what constitutes due process of law, arises as often when judicial action is in question as in any other cases. But it is not so difficult here to arrive at satisfactory conclusions, since the bounds of the judicial authority are much better defined than those of the

legislative, and each case can generally be brought to the test of definite and well-settled rules of law."

Cooley's Constitutional Limitations (8th Ed., Vol. II, p. 845.

The judicial authorities of a State are bound by the prohibition of the Fourteenth Amendment. *Chicago, etc., Railroad Company* v. *Chicago*, 166 U. S., 226, 17 S. Ct., 581, 41 L. Ed., 979.

The very first order entered by the District Judge in this case approving Debtor's petition directed the State receivers to turn over all funds in their possession. This was on June 6, 1941. This was followed by the turn-over order entered on June 10, 1941. Without any notice or hearing, all custodians of the State deposits were ordered to surrender the deposits to the Trustee in Bankruptcy. (Tr., p. 11)

None of the custodians of the State deposits or the State Court Receivers, except the West Virginia State Court Receiver, complied with the order. Finally, perceiving that the order was invalid, on motion of the Central Trust Company, these orders were modified so as to permit the State custodians and State Receivers to retain the securities and merely to enjoin them from disposing of them. (Order entered August 9, 1941, Tr., pp. 102-114)

Although Congress withheld from the Bankruptcy Court summary jurisdiction over these deposits, Securities & Exchange Commission is now asking this Court to interpret Chapter X of the Bankruptcy Act in such manner as to supply this power to the Bankruptcy Court. A decision that a liquidation of Fidelity under Chapter X proceeding in the United States District Court for the Southern Dis-

trict of West Virginia, where a petition in ordinary bankruptcy could not be filed by or against it, in order that the State deposits may be "marshaled" in that Court in the way in which Securities & Exchange Commission so strenuously insist should be done, would amount to a validation by this Court of the summary turn-over order made by the District Judge on June 10th. The very next thing that would happen would be a renewal of the order of June 10th in the District Court pursuant to the power which the Court reserved in the modifying order of August 9th. (Tr., p. 113) Petitioners and Securities & Exchange Commission make no effort to conceal their intentions. Their argument is grounded upon the presumed inadequacy of ancillary proceedings. They base their appeal upon the necessity of bringing all of the State deposits into the Bankruptcy Court under compulsion.

We respectfully insist that an interpretation of Chapter X of the Bankruptcy Act so contrary to any that has heretofore been given it, under all the attendant circumstances, would be so grossly arbitrary and unreasonable as to be incompatible with the fundamental law and a denial of due process to contract holders claiming the security of the State deposits.

CONCLUSION.

If the case were to be settled as a problem of dialectic concerning the powers and jurisdiction of the Bankruptcy Court, respondents, by reason therefor, would not be disquieted. But the ends of justice will not be subserved merely by the solution of abstract legal problems.

In the final analysis the question in the case is not what the Bankruptcy Court *may* do, but what it *ought* to do.

Can any possible benefit flow to the contract holders from the continuation of this proceeding? Who will benefit? When will they derive the benefits? How much will they benefit? These are the practical questions in the case that must not be sidetracked for legal theories.

Eighty thousand contract holders are not apathetic. They are not interested in fine legal points which lawyers excogitate. Scattered in twenty-nine States with an average claim of $250.00 each, they could not afford to employ the necessary accountants and lawyers to take part in Court hearings in a distant State. They rely upon their common sense, the most infallible of counsellors, which tells them that this company is *through*, and while reorganization may be talked about, it will never be accomplished.

They were induced to put money in the company because they thought it was secured by the deposits. Everyone assured them of that. They had the sales prospectuses of the company, the salesmen's representation, the assurance of their own State insurance or securities department, and if they consulted them, the advice of their lawyers. Also, if they came in after the news of the Securities & Exchange Commission's intervention had been disseminated, they felt

that they had an additional guaranty that the plan was safe and sound and in conformity with the laws of the land.

There are in array against them the company itself, the Trustee appointed by the Court in Charleston, and Securities & Exchange Commission. The case which they insist for not only goes beyond settled principles of equity in bankruptcy, but is jarring upon the American sense of freedom, order and justice.

The fact that contract holders are entitled to look to the State deposits for their protection is too firmly embedded in the minds and consciousness of too many people to be uprooted by the eccentric premises which have been advanced. It tends to cast reproach upon too much that has been done in good faith, over so long a period of time, and by so many honest men. The striking down of the State deposits can only be purchased by paying a high price in American honor—the company was wrong, the officials were acting in bad fath, State laws were no good, State officials were acting in bad conscience. And what of the position of Securities & Exchange Commission which permitted State deposits to be created in this manner.

Liberty-loving Americans who cherish their institutions are appalled at the idea that a Bankruptcy Court would say: "Your State regulation has been no good, *surrender* everything that you have counted on and come up to Charleston, West Virginia, and prove, if you can, what yours rights are." They prefer to think that it is in keeping with the principles which Americans hold high and sacred that they be privileged to say, "You sent these securites to us. We accepted them in good faith. We assumed there was the same measure of good faith on your part. We thought that you knew what you were doing. Our Courts are open

and they are just. If you conceive that there has been error come where we are and where the property is located and prove it. Be assured that we want nothing that we cannot keep in the clearest conscience."

It is not difficult to see the delay, the expense and the hardship on contract holders, which an affirmance of the decision of the District Judge would entail. First, the entire Twenty Million Dollars of securities held in the State deposits would have to be surrendered to the Trustee in Charleston just as it was ordered to be done on June 10, 1941. Since few individual contract holders can afford to employ attorneys and accountants and incur the expenses of attending hearings there, groups of them will have to organize protective committees. After hearings almost innumerable, the Court will rearrange the contract holders according to some scheme. The Trustee already contends that no plan of liquidation can be worked out until this has been done. Then will follow the flock of appeals to the Circuit Court of Appeals and from thence the case will wind its tedious way back to this Court.

If this happens, many of us might as well plan to devote the next decade to this muddle-clearing. There will be the annual costs in administrative expenses of the estate amounting to $150,000.00, the risk of depreciation or decline in securities, the possible liability for a large amount of additional income taxes that will accrue if the contention of the Federal government is sustained that the estate must pay Federal income taxes on all the income from the securities held in the State deposits, the compensation to attorneys for the contract holders and protective committees, and what will not be least of all the over-all fees on the whole Twenty Million Dollar estate that may be

allowed to the Trustee and its attorneys after the deposits have been surrendered and the *slow* liquidation is conducted at Charleston. The contract holders' burden will not be eased, whether the plan of payment be on a pay-as-you-go or pay-as-you-stay basis.

There are contract holders who were laying aside their money to pay for the education of their children. There are others who put aside the savings for sickness, marriage and old age. Many of them need their money now. What untold amount of inconvenience and suffering will follow in the wake of the device that is formed to liquidate the assets as slowly as necessary and as expeditiously as is possible under such circumstances!

We submit again, as we have ever done, that the underlying issue is one of *good faith*. Debtor's case should be scrutinized with extreme care lest the Federal Courts unwittingly be used as an instrumentality for breaking faith with many thousands of humble persons who are as sheep dumb before their shearers.

Respectfully Submitted,
WELDON B. WHITE,
FYKE FARMER,
RUDOLPH K. SCHURR.

The State of Tennessee, through its Attorney-General, concurs in the foregoing brief and also in the joint *amici curiae* brief filed on behalf of the other States.

ROY H. BEELER,
Attorney-General of the State of Tennessee
NAT TIPTON,
Assistant Attorney-General of the State of Tennessee

APPENDIX A

Reports sent to Insurance Commissioner of Tennessee, filed as Exhibit 77.

July 25, 1939

Hon. James M. McCormack, Commissioner
Department of Insurance and Banking
State of Tennessee
Nashville, Tennessee

Dear Sir:

In accordance with arrangements previously made, we are enclosing a certificate showing the cash liability as of June 30, 1939 on all contracts held by residents of your State.

We now have on deposit securities with a par value of $161,-000.00 and a market value of $170,896.88 as of June 30, 1939.

Very truly yours,
F. J. McNulty
Assistant Secretary

FJMcN CMH

FIDELITY INVESTMENT ASSOCIATION

JUNE 30, 1939

CASH LIABILITY—STATE OF TENNESSEE

Account	*Net Cash Liability*
Income Contract	$ 311.59
Special Annuity Contract	34,488.79
Special Annuity Contract, Maturity and Retirement	18,233.51
Income Reserve Contract, Series "A"	385.00
Income Reserve Contract, Series "B"	69,223.29
Income Reserve Contract, Series "B" Maturity and Retirement	24,469.17
Income Reserve Contract, Series "D"	408.00
	$147,519.35

STATE OF WEST VIRGINIA
COUNTY OF OHIO

A. L. King and W. J. Gribber, after being first duly sworn, depose and say that they are Vice President and Auditor, respectively, of the Fidelity Investment Association, and further state that the foregoing statement of cash liability on all contracts held by residents of the State of Tennessee at June 30, 1939 is true and correct to the best of their knowledge and belief.

....
Vice President

....
Auditor

Subscribed and sworn to before me, a Notary Public, this 25th day of July, 1939

....
Notary Public
My commission expires December 9, 1939

March 20, 1940

Hon. James M. McCormack, Commissioner
Department of Insurance and Banking
State of Tennessee
Nashville, Tennessee

Dear Mr. McCormack:

As indicated in Mr. Young's letter to you dated March 7, 1940, we are enclosing the Certificate of Liability covering all contracts held by residents of the State of Tennessee, as of February 29, 1940.

Our records indicate that the securities on deposit for the protection of these contract-owners, as of February 29, 1940, had a par value of $161,000; book value of $167,163.30; and a market value of $168,415.00.

Mr. Young is handling the arrangements concerning an additional deposit and the securities will be sent to you, after final approval by your Department.

Very truly yours,
F. J. McNulty
Secretary

FJMcN/CMH

FIDELITY INVESTMENT ASSOCIATION

February 29, 1940

CASH LIABILITY—STATE OF TENNESSEE

Account	*Net Cash Liability*
Income Contract	$ 408.12
Special Annuity Contract	28,184.21
Special Annuity Contract, Maturity and Retirement	19,323.67
Income Reserve Contract, Series "A"	460.00
Income Reserve Contract, Series "B"	110,617.64
Income Reserve Contract, Series "B" Maturity and Retirement	12,641.54
	$171,635.18

State of West Virginia
County of Ohio

A. L. King and W. J. Gribben, after being first duly sworn, depose and say that they are Vice President and Auditor, respectively, of the Fidelity Investment Association, and further state that the foregoing statement of cash liability on all contracts held by residents of the State of Tennessee at February 29, 1940 is true and correct to the best of their knowledge and belief.

....
Vice President

....
Auditor

Subscribed and sworn to before me, a Notary Public, this 19th days of March, 1940

....

My commission expires October 13, 1941

October 19, 1940.

Mr. T. E. Miles
Deputy Commissioner
Department of Insurance & Banking
Nashville, Tennessee

Dear Mr. Miles:

In accordance with arrangements previously made, we are enclosing a certificate indicating our cash liability in the State of Tennessee as of September 30, 1940. Included in this certificate is a statement as to the market value of securities on deposit as of that date.

For your convenience in checking the market value of the securities, we are enclosing an itemized list showing the par value, description and the market value, as of September 30, 1940. The market quotations, as shown on the attached list, were furnished to us by the firm of Minsch, Monell and Company, Incorporated of New York City.

Very truly yours,

F. J. McNulty
Vice President and Secretary

FJMcN:CMH

FIDELITY INVESTMENT ASSOCIATION

SEPTEMBER 30, 1940

CASH LIABILITY—STATE OF TENNESSEE

Account	*Net Cash Liability*
Income Contract	$ 3,540.02
Special Annuity Contract	18,233.79
Special Annuity Contract, Maturity and Retirement	15,462.31
Income Reserve Contract, Series "A"	594.50
Income Reserve Contract, Series "B"	119,054.10
Income Reserve Contract, Series "B" Maturity and Retirement	16,987.12
Income Reserve Contract, Series "D"	642.00
	$174,513.84

Market Value of Securities on deposit at September 30, 1940, $187,206.25

State of West Virginia
County of Ohio

A. L. King and F. J. McNulty, after being first duly sworn, depose and say that they are Vice President and Secretary, respectively, of the Fidelity Investment Association, and further state that the foregoing statement of cash liability on all contracts held by residents of the State of Tennessee at September 30, 1940, and the market value of securities on deposit as of the same date, are true and correct to the best of their knowledge and belief.

.... Vice President

.... Secretary

Subscribed and sworn to before me, a Notary Public, this 17th day of October, 1940

....

My commission expires October 13, 1941

SECURITIES ON DEPOSIT WITH STATE OF TENNESSEE AS OF SEPTEMBER 30, 1940

Par Value	*Name and Description*	*Market Value*
$ 22,000	Fayette County, Tennessee, Road & Bridge Issue No. 2. 4 3/4s 1958	$ 23,100.00
1,000	Marion County, Tennessee, School 4s 1964	940.00
4,000	Marion County, Tennessee, School 4s 1965	3,760.00
4,000	Marion County, Tennessee, School 4s 1966	3,760.00
4,000	Marion County, Tennessee, School 4s 1967	3,760.00
15,000	McNairy County, Tennessee, County Ref. 3½-5s 1962	12,150.00
19,000	Morgan County, Tennessee, Gen. Ref. 3-4½s 1955	13,870.00
48,000	New York City, Corporate Stock of, Gen. to Provide for Supply of Water 3½s 1976	50,760.00
15,000	Rhea, County of, Tennessee, Gen. Indebtedness 6s 1965	12,000.00
15,000	Roane, County, Tennessee, Ref. "A" 5s 1956	12,000.00
3,000	Sheffield, City of, Alabama, Water Revenue 4½s 1952	3,000.00
5,000	Sheffield, City of, Alabama, Water Revenue 4½s 1953	5,000.00
2,000	Sheffield, City of, Alabama, Water Revenue 4½s 1954	2,000.00
3,000	Sheffield, City of, Alabama, Water Revenue 4½s 1962	3,000.00
35,000	United States of America Treasury 2 7/8s 1960/55	38,106.25
$195,000		$187,206.25

APPENDIX B

RULING OF COURT ON OCT. 6, 1941, CONCERNING TRUSTEE'S SECTION ONE SIXTY SEVEN REPORT. (PAGES 3008-12 OF TYPEWRITTEN RECORD.)

"MR. PALMER: This is the day in which the trustee was to have filed its report, and I am wondering if copies are available for counsel at this time. If they are available I would like the opportunity to examine them.

THE COURT: I have already ruled that the trustee's report is not connected in any way with this proceeding in connection with any cross-examination.

MR. PALMER: I understand.

(There was a discussion off the record.)

MR. FARMER: I don't care to amplify what the record already shows, only as the matter came up last week, the first day. I stated my insistence that the trustee ought to make its report as to the desirability of reorganization. Your Honor made the same ruling last week that you made today. I don't care to press the matter further, but I wish to state an exception.

THE COURT: You were talking about the—

MR. FARMER: I was talking about the trustee.

MR. T. C. TOWNSEND: I understood in connection with the trustee's report, your Honor, that your Honor had very definitely ruled that report would not be considered in connection with the present proceedings.

THE COURT: That is correct.

MR. T. C. TOWNSEND: And the Court hasn't altered that ruling. Now, I do want to say that it is my information that there will be a partial report under Section 167 to be filed with

the Court probably late today or tomorrow, and the trustees are continuing to work on an additional and further report; and in that connection, I want to say also that at the time the Court fixed October 6 as the date for the making of the report of the trustee, nobody anticipated that the present proceedings would continue for the length of time they have been drawn out, and in view of that, the Court probably ought to extend the time, in his discretion, for the trustee to make an additional and further report to anything that I might have to report at this time.

MR. FARMER: We object to any extension of time, because we think that no sufficient excuse has been offered for the failure of the trustee to have the report here and available for all the parties interested in this hearing.

THE COURT: I will extend the time to November 5, 1941, and ask the trustee to make as complete a report at that time as may be done, and if the report cannot be made completely at that time, then we will take up the question of further extension.

MR. PALMER: In that connection, will the trustee make its partial report now for the use of those who desire to make use of it, and also the time for these who wish to file a plan for the trustee extended from November 6 until December 5. At the present time, the Court's ruling is that on October 6 the trustee shall file its report, and those who desire to file a possible plan of the trustee will have a month to study it and submit their findings on November 6; and I am suggesting to the Court, if it is agreeable to the trustee, if they have this partial report, to submit it to those counsel interested, and then a further extension of time be granted for the complete report, and then an extension of time be granted after that complete report for a study of it, so that proper plans can be offered the trustee.

THE COURT: That would depend on just what character this partial report is. If the partial report is such that it can include all the necessary information that these persons would need who expect to submit the plan, then I don't see any reason for extending the time. If not, then I would extend the time, and we

can probably tell more about that when we hear just what the scope of the present report is.

MR. PALMER: I understand that the present report will be made available to counsel not for cross-examination in this case, as the Court ruled, but I mean available to counsel for their information.

THE COURT: I don't know whether it is available in the sense that there are copies made for all counsel or not."

SUPREME COURT OF THE UNITED STATES.

No. 319.—October Term, 1942.

Fidelity Assurance Association, a corporation, Debtor, et al., Petitioners, *vs.* Edgar B. Sims, Auditor of the State of West Virginia, etc., et al.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[April 5, 1943.]

Mr. Justice Roberts delivered the opinion of the Court.

This case presents important questions concerning the construction of Chapter X of the Bankruptcy Act.[1] Many states of the Union are interested because of the asserted incidence of its provisions upon state laws and rights thereby created. A number of state officers[2] are parties.

Fidelity Assurance Association, a West Virginia corporation, filed its petition for reorganization in the District Court for Southern West Virginia. The Judge made an order approving the petition as properly filed. He also entered orders enjoining state officials from dealing with property held by them.[2]

State banking and insurance commissioners and state court receivers answered, asserting that the debtor could not avail itself of the Act because it was an insurance company[3] and, in any event, the petition was not filed in good faith, as the phrase is defined in § 146(3)(4) of Chapter X.[4] The Securities and Exchange Commission intervened at the request of the District Court. After trial of the issues, the court formally approved the petition and overruled the motions to rescind the decrees granting injunctions.[5] The Circuit Court of Appeals reversed.[6]

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1 Act of June 22, 1938, 52 Stat. 840, 883; 11 U. S. C. §§ 501-676, incl.

2 An appeal was taken from the District Court's refusal to rescind the orders. The Circuit Court of Appeals refused to disturb them at that stage of the proceeding. Sims v. Central Trust Co., 123 F. 2d 89.

3 Act of July 1, 1898, c. 541, § 4, 30 Stat. 547, as amended, 11 U. S. C. § 22.

4 11 U. S. C. § 546.

5 42 F. Supp. 973.

6 129 F. 2d 442.

The debtor was organized April 11, 1911, under the name of Fidelity Investment and Loan Association. Its corporate purposes were enlarged in 1912 to include the soliciting and receiving of payments on annuity contracts. Thereby it became subject to the provisions of Art. 9 of Ch. 33 of the Code of West Virginia,[7] relating to the selling of annuity contracts and, as therein provided, to the supervision of the Auditor, as ex-officio Insurance Commissioner of the State.

From December 1912 to the close of 1940 the company's business was the selling of investment contracts and for this purpose it was licensed in many states. It altered its contracts from time to time but in general they consisted of certificates evidencing the agreement of the purchaser to make specified periodic payments and the company's agreement that upon the expiration of a stipulated term it would return to him in instalments a sum designated as the face amount, or pay a lump sum less than the face amount.

During the six years preceding December 30, 1940, the debtor sold a contract having a collateral insurance feature provided by a blanket policy procured by Fidelity from Lincoln National Life Insurance Company. Approximately seventy-five per cent. of the contracts issued after 1934 contained this feature.

It will be seen that the business was essentially the conduct of a compulsory savings plan. The interest paid a certificate holder was at a low rate and the penalty for failure to keep a certificate alive was heavy. The expense of selling the contracts was inordinately high and, in spite of a large volume of sales, the company was constantly falling behind and suffering serious losses.

The present Insurance Commissioner of West Virginia took office in 1933. It was his duty to require and approve the deposit with the State Treasurer of bonds and securities to be held in trust for the benefit of the company's West Virginia contract holders to an amount equal to the cash liability to them; to require a similar deposit in trust for the benefit of holders located in other states to the extent that the laws of such states did not provide for a deposit equal to, or greater than, that called for by the laws of West Virginia. Shortly after taking office, the Commissioner dis-

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[7] Michie's W. Va. Code 1937, p. 1204 ff. This Article was repealed by chapter 46, § 12, Acts of West Virginia, 1941, effective ninety days from March 8, 1941, but this fact is irrelevant to any issue in this case.

covered that the company was insolvent. There is a long history of negotiations and requirements, extending almost to the time of filing the petition, in an effort to restore it to a solvent condition.

The company was at one time licensed in twenty-nine states each of which had laws regulating its business; fifteen required a deposit of approved investment obligations with some state official to secure payment of outstanding contracts held by residents; the remainder had no such requirement, but the contracts sold in these states were secured by the deposit made with West Virginia.[8] As of the date of the filing of the debtor's petition, the deposits made with various states, including West Virginia, amounted, according to the debtor's figures, to $20,056,680.27 against a net reserve liability of $24,221,651.36. In addition, the company had securities not deposited anywhere valued at $556,467.51, most of which were ineligible for deposit under the laws of any state, and $500,000 in cash.

Each of the series of contracts sold by Fidelity embodied provisions for the creation and maintenance of a reserve fund. All of the contracts provided that the reserve fund maintained by the company should be invested in approved securities and deposited in trust as required by the laws of West Virginia. Securities purchased with the moneys paid by the contract holders were deposited with the Treasurer of West Virginia and officials of other states in compliance with their respective laws, but no effective effort was made to designate the source of the funds with which securities were purchased so as to identify the latter as belonging to the reserve of any series, nor did the state authorities make any such allocation. The securities on deposit with the states were at all times treated by the debtor and state authorities, as securing all obligations to contract holders in the state where each deposit was made, and reports by the company to the states respecting total liabilities failed to show such liabilities by funds or series. There were certificate holders in all forty-eight states, the District of Columbia, and foreign countries.

December 14, 1938, the Securities and Exchange Commission sought an injunction in a federal court, alleging the Company was engaged in acts and practices violative of the fraud provisions of § 17 (a) of the Securities Act of 1933.[9] This suit resulted in an

8 The security afforded by these laws was stressed by sales agents and was effective in the procurement of contracts.

9 Act of May 27, 1933, c. 38, Tit. I, § 17, 48 Stat. 84, 15 U. S. C. § 77 q.

injunction and was followed by another for appointment of a receiver in a federal court in West Virginia, which was dismissed.[10]

Prior to 1938 the debtor had made efforts to obtain fresh capital to be used in reorganizing its business. After 1938 the effort was continuous, but no capital was forthcoming.

Despite enormous sales[11] the company could not attain a solvent position. Moreover, the publicity ensuing the two suits resulted in the surrender of many contracts, the temporary suspension of the sale of new certificates, and a serious diminution of sales when activity was resumed.[12]

Pursuant to the Public Utility Holding Company Act of 1935,[13] the Securities and Exchange Commission conducted an investigation and reported its findings respecting Fidelity's business and other matters to Congress on March 13, 1940. As a result the Investment Company Act of August 22, 1940,[14] was adopted. Fidelity's officers and directors realized that the company could not meet the statutory requirements and survive. They, therefore, cast about for some other business to which the corporate resources might be devoted. They hit upon life insurance.

Accordingly, on December 31, 1940, the debtor amended its charter. The amendment changed its name to Fidelity Assurance Association, eliminated the existing corporate powers and purposes, and adopted as the corporate purpose "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase, and dispose of annuities". In January 1941, by charter amendment, the authorized capital stock was altered in order to qualify the company to transact a life insurance business in West Virginia and elsewhere. The Company also registered under § 8a of the Investment Company Act, *supra*, so that it might continue to service outstanding contracts. The Insurance Commissioner of West Virginia issued a license for the conduct of an insurance business but with the understanding that no such business should be written until the company's affairs had been put into satisfactory order. Notwithstanding this arrangement, the company, by written negotiations,

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10 McCammon v. Fidelity Investment Association, 27 F. Supp. 117, affirmed Hutchinson v. Fidelity Investment Ass'n., 106 F. 2d 431.

11 The gross business written in 1938 was $52,000,000.

12 Sales in 1940 were $12,000,000.

13 Act of August 26, 1935, c. 687, Tit. I, § 30, 49 Stat. 837, 15 U. S. C. § 79z-4.

14 c. 686, 54 Stat. 789, 15 U. S. C. § 80a-1 *et seq.*

procured some 9800 of its certificate holders to accept an amendment of their outstanding certificates providing an insurance obligation on the part of the company.

At the instance of the Insurance Commissioner, the Attorney General of West Virginia, on April 11, 1941, instituted proceedings for the appointment of a receiver in the Circuit Court of Kanawha County. The company entered an appearance but interposed no answer or objection. The court appointed receivers who took over the cash and undeposited securities but did not essay to obtain possession of the assets on deposit with the Treasurer of West Virginia or with officials of other states. The authorities of the various states were notified of the pendency of this suit. Thereafter proceedings were instituted or steps taken by state officers, pursuant to state law, for the liquidation of the company's obligations to local certificate holders in Wisconsin, Iowa, Ohio, Illinois, Tennessee, Missouri, Indiana, Kentucky, Maryland, and Pennsylvania.

The respondents, other than Securities and Exchange Commission, contended below, and urge here, that the petition should be dismissed since (1) the debtor is an insurance company exempted from the provisions of the Bankruptcy Act, (2) the petition was not filed in good faith. The debtor, the trustee appointed under Chapter X, and the Commission, successfully opposed these contentions in the District Court. The Circuit Court of Appeals held with the respondents on both grounds. We find it unnecessary to consider or decide whether, at the date of filing, the debtor was an insurance company within the meaning of the Act; for we think the Circuit Court of Appeals was right in holding the petition not filed in good faith as the phrase is defined in § 146(3) and (4).

Section 144[15] requires that if the judge is not "satisfied" that the petition "has been filed in good faith" he shall dismiss it. The relevant portions of § 146[16] are that "a petition shall be deemed not to be filed in good faith if . . . (3) it is unreasonable to expect that a plan of reorganization can be effected; or (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

15 11 U. S. C. § 544.

16 11 U. S. C. § 546.

As the court below has said, in applying the statutory test the situation should be viewed realistically. If this be done, we think the rejection by the court below of the claim of the debtor and its trustee that it can be reorganized as a going concern must be affirmed. In appraising the soundness of this claim, certain facts additional to those already noticed must be kept in mind. On April 10, 1941, there were 87,999 contracts outstanding for a face amount of $181,948,026.70. At that time liabilities exceeded assets, on the company's showing, by $2,500,000. The business written in 1940 had shrunk to 23% of that written in 1938. The Company had been losing money at the rate of $250,000 per annum. Its sale of investment certificates had ceased December 30, 1940, and, even if it had been possible to resume this activity in compliance with the requirements of the Investment Company Act, the reestablishment of the sales force would have cost $500,000.

In the light of all relevant facts, it seems clear that Fidelity cannot be reorganized for the purpose of conducting its old business of selling investment certificates. Conviction that this was so led its managers to attempt to alter its corporate purposes to those of a life insurance company. The District Judge said: "It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the debtor as a face amount certificate company." And he added: "It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future."

There is no prospect that the debtor can be reorganized as an insurance company and the District Judge did not find that it could.

The petitioners say: "Upon this record, can it be said that it is unreasonable to expect that some insurance or investment company can be found to take over or buy the assets of Fidelity under a contract for the benefit of the Fidelity contract holders, to issue them investment certificates or insurance policies, of one or more kinds of greater value than the dividends to such contract holders through the liquidation of Fidelity would buy?"

The court below properly concluded that "the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims[17] to enable the company to go on is so remote as to exist only in the imagination."

Petitioners and Securities and Exchange Commission urge, however, that Chapter X may be employed to accomplish a slow and orderly liquidation which they say is imperative in the interest of all creditors. The District Court so held.

It must be remembered that Fidelity is admittedly insolvent and no one suggests there is any equity in its stock; that there is one greatly preponderant class of creditors,—certificate holders—all having security for their claims on one or more deposits with state authorities, and all having unsecured claims against the unpledged assets of the debtor. The necessity for decision as to the relative rights of these classes in pledged assets may present difficult questions of distribution, but has little, if any, bearing upon the method of turning the debtor's assets into money.

The deposited securities are generally readily marketable at favorable prices. They are scattered through fifteen states in hands of public officials whose duty it is to liquidate them on terms most favorable to those for whose protection they stand pledged. The suggestion that these quasi-trustees will force the securities on the market without regard to its ability to absorb them, to the destruction of their beneficiaries' security, is inadmissible and, in addition, is contrary to what occurred after the institution of the West Virginia receivership. There is no foundation for the position that the so-called reorganization should take the form of the creation of a new corporation to which all these securities would be transferred for conversion into cash, particularly as the advocates of such a project admit that the application of the security afforded classes of certificate holders according to state law cannot be avoided in any distribution of assets.

It is urged that a plan of liquidation may constitute a reorganization under Chapter X, and decisions are cited to that point,[18] but an examination of them will demonstrate that in none save where the corporate purpose of the debtor was, in effect, holding and liquidating securities was the plan such as is proposed here.

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17 The claims average less than $273 each.

18 In re Central Funding Corp., 75 F. 2d 256; In re Mortgage Securities Corp., 75 F. 2d 261; Continental Ins. Co. v. Louisiana Oil Ref. Corp., 89 F. 2d 333; R. L. Witters Associates v. Ebsary Gypsum Co., 93 F. 2d 746; In re Porto Rican American Tobacco Co., 112 F. 2d 655.

Under the facts of this case, the suggested plan is but an alternative for ordinary bankruptcy without any readjustment of the rights of creditors and stockholders *inter se*, and this fact serves to distinguish the remaining cases on which reliance is placed.

We conclude that, in this aspect, good faith, in the statutory sense, is lacking since no such reorganization as the statute was intended to accomplish is reasonably to be expected.

In the second place, we hold that the interests of creditors would be best subserved in the pending prior proceedings in West Virginia and other states. The court below was of this opinion for these reasons: It appears unlikely that there will be any surplus after payment of local claimants in any state other than West Virginia; state law must govern the distribution of the respective deposits; creditors can as readily present claims against the surplus of the West Virginia deposit in the West Virginia court as in the federal court in this proceeding.

The Securities and Exchange Commission insists that the Chapter X proceeding is more advantageous as affording opportunity for impartial investigation of wrongdoing by company officers, and the solution of problems of marshalling and distribution. If, as the court below held, nothing is to be accomplished but the liquidation of Fidelity, it is difficult to see why that process and consequent distribution of the proceeds should be held up by the search for causes of action against officers and directors. Nor is any convincing showing made that such investigation cannot, or will not, be made and availed of by the state court receivers. Moreover, if Fidelity is not an insurance company, it could have been put into ordinary bankruptcy, orderly liquidation accomplished, and impartial investigation made by a trustee elected by the creditors.

There are no true problems of marshalling presented. Creditors in the various states will unquestionably go first against the local deposits. They may, or may not, be paid in full from those funds. They will have claims against the surplus of the West Virginia fund for any deficiency. On the other hand, a surplus in a state fund after satisfaction of local creditors, will be added to the surplus fund in West Virginia for the benefit of all having claims against it. Rights against local deposits will be adjudicated by the courts of the states, near the homes of the beneficiaries and at a minimum of inconvenience, delay, and expense.

The advantages of bringing all these funds to the District Court for administration in conformity to diverse state law, and compelling claimants to come there to assert their rights, are not apparent.

It is said, however, that Fidelity agreed to segregate the reserve fund of each series, and that the holders of certificates in any series are entitled to have the securities purchased for the reserve of that series traced and set apart for their benefit, and that this can be done only in the present proceeding by bringing all the funds under a single administration.

Without reciting the facts in detail, it is enough to say that, while the different reserve funds were separately set up on the books of the company, they were, for the greater part of the period in question, kept in a single bank account and the securities purchased for the various reserve funds were not earmarked as such. Moreover, for the most part, securities deposited with state authorities were not, at the time of the deposit, designated as belonging to the reserve fund for any series of contracts. In some instances designations of them were made subsequent to their deposit. In addition, it is to be noted that under the law of West Virginia and that of other states having deposits, the securities deposited are made a common fund for the protection of all outstanding contracts, and the certificate holders were advised by the company in its literature that it proposed to deposit reserve fund securities in accordance with the law of the states. The situation discloses so many difficulties of law and fact as to render segregation for purposes of distribution of the avails of the securities improbable. And the smallness of the average amount due certificate holders indicates that the expense of the effort, if successful, would in the end prove more detrimental to a claimant than foregoing the trifling advantage of a reallocation of securities to the respective reserve funds.

It was suggested at the bar that, even if liquidation is all that can be hoped, this would be better managed by a single bankruptcy court than in several separate proceedings. The difficulty with the suggestion is that Congress did not intend resort to Chapter X to be had for the mere purpose of liquidation. The scheme of the chapter precludes any such conclusion. The mandate of § 144 is clear that unless the judge is satisfied the petition was filed in good faith he must dismiss it. Under the predecessor of Chapter

X,—§ 77 B of the Bankruptcy Act—the district judge was given authority, by subsection (c) (8),[19] under certain circumstances, to "direct the estate to be liquidated, or direct the trustees to liquidate the estate . . . ." In Chapter X, on the other hand, § 236 (2)[20] provides that if no plan is approved or accepted, or if it is not consummated, the judge may, after hearing all persons in interest, adjudge the debtor a bankrupt or dismiss the proceeding as he may decide is in the interest of creditors and stockholders. Thus the statute does not contemplate a liquidation in a Chapter X proceeding but a liquidation in ordinary bankruptcy or a dismissal outright.

If the liquidation of Fidelity's affairs in bankruptcy had been proposed at the start, the petition in bankruptcy could not have been filed in the District Court for the Southern District of West Virginia in which this proceeding is pending. A Chapter X proceeding may, under § 128,[21] be initiated either at the principal place of business of the corporation or where it has its principal assets. The present proceeding was initiated in the Southern District on the ground that the principal assets of the company are located at Charleston in that district in the possession of the State Treasurer. Under § 2 of the Bankruptcy Act,[22] an ordinary bankruptcy may be initiated only at the corporation's principal place of business, which is Wheeling in the Northern District of West Virginia.

Congress did not intend a Chapter X case to be turned into a liquidation proceeding at the outset, but intended the litigation to become a straight bankruptcy only after the failure to consummate a plan, and meant to limit the parties to their remedy in ordinary bankruptcy in all other cases. It would, therefore, be a perversion of the Congressional intent to treat the present as a liquidation proceeding, since the rights of persons having liens or security pledged for their claims differ widely in the two sorts of bankruptcy.

The judgment is affirmed.

Mr. Justice Douglas and Mr. Justice Rutledge took no part in the consideration or decision of this case.

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[19] 11 U. S. C. § 207 (c) (8).

[20] 11 U. S. C. § 636 (2).

[21] 11 U. S. C. § 528.

[22] 11 U. S. C. § 11.